

A Work Project, presented as part of the requirements for the Award of a Master Degree in Economics / Finance / Management from the NOVA – School of Business and Economics.

HOTEL INDUSTRY GROWTH TRENDS – THE CASE
OF INTERCONTINENTAL HOTELS GROUP

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A Project carried out on the Master in Finance Program, under the supervision of:

(Francisco Martins)

3 JANUARY 2020

Abstract

IHG is considered one of the biggest companies from hotel industry. Its presence is spread worldwide, accounting with more than 5,600 franchised, managed, owned and leased hotels. Its revenues are reported according to three regions – Americas, EMEAA and Greater China. IHG has been developing expansionist strategies, improving its business models and aligning its corporate goals in order to obtain long-term sustainability. We performed an analysis of IHG business models and value drivers, researched about its major competitors and incorporated the main industry trends in the forecast. It was adopted the DCF methodology in order to determine the FY20 share price.

Keywords:

- RevPAR
- Hotel Industry
- Business models
- Share price

INTERCONTINENTAL HOTELS GROUP

TOURISM

STUDENTS: PEDRO AVELAR | TIAGO MARTINS

COMPANY REPORT

03 JANUARY 2020

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Hotel Industry Growth Trends

Predicting the future of a giant

▪ According to our valuation for the InterContinental Hotels Group (IHG), the FY20 target price of \$77.96 represents an increase of 13.53% from the current traded price. Due to its strategic model and future goals, we have strong convictions that our predictions will be achieved.

▪ During 2019, it is estimated an increase of IHG's aggregated revenues of 3.78%. Despite of Americas being the geographical region with the highest revenues amount (53.57% of the total), Greater China will be the region growing the most, with an increase of 14.23% in the same caption. Is it possible to maintain this trend for the future?

▪ The company has three types of business: (i) Franchised, (ii) Managed and (iii) Owned, leased and managed leased. Types (i) and (ii) form the Fee Business. IHG's hotels are predominantly in fee business (more than 99%), and the purpose is to keep going on this strategy, the same as the other players of the industry – are they thinking right?

▪ We used a DCF to calculate the YE20 target price. By doing an accurate and realistic forecast, we ended up with a WACC of 6.4% and a growth rate of 1.71%.

Company description

IHG is a public limited company and one of the most known in the sector, whose brands are spread all over the world. Its main focus is to provide "True Hospitality" for everyone and to continue the growth strategy. Founded in 2003, is one of the companies traded in the FTSE 100 Component index.

Recommendation: BUY

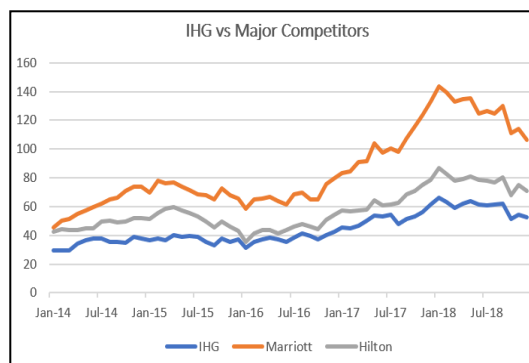
Price Target FY20: \$77.96

Price (as of 3-Jan-2019) \$68.67

Bloomberg: IHG:US

52-week range (\$)	55.14-71.02
Market Cap (\$m)	11,123.85
Outstanding Shares (m)	182.03
Shareholders' gains (per share, \$)	11.63

Source: Bloomberg, Company data and Analysts



Source: Bloomberg

(Values in € millions)	2018	2019E	2020F
Revenues	1,933	2,006	2,030
EBITDA	750	883	880
Net Income	352	494	491
EPS	184.7	271.3	269.9
EBITDA margin (%)	38.8	44.0	43.4

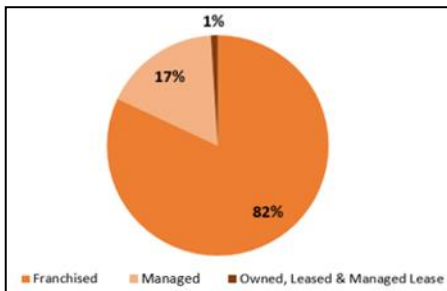
Source: Analysts

THIS REPORT WAS PREPARED EXCLUSIVELY FOR ACADEMIC PURPOSES BY PEDRO AVELAR AND TIAGO MARTINS, MASTER IN FINANCE STUDENTS OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS. THE REPORT WAS SUPERVISED BY A NOVA SBE FACULTY MEMBER, ACTING IN A MERE ACADEMIC CAPACITY, WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL. (PLEASE REFER TO THE DISCLOSURES AND DISCLAIMERS AT END OF THE DOCUMENT)

Table of Contents

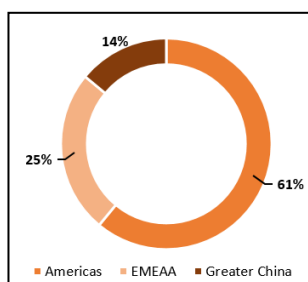
Company Overview	3
Strategy and Business Models.....	5
Shareholders Structure and Dividend Policy.....	8
Industry Analysis.....	9
Competitors.....	10
Future Trends and Challenges	11
Asset-Light Business Model.....	11
Economic Evolution	13
Online Travel Agents (OTAs).....	14
Valuation Assumptions.....	17
Revenues Forecasts.....	17
PP&E & NWC	19
WACC & Growth Rate	20
Valuation Results.....	21
Multiples Valuation.....	22
Scenario Analysis	22
Sensitivity Analysis	24
Appendix.....	25
Financial Statements – Balance Sheet	25
Financial Statements – Income Statement.....	26
Financial Statements – Cash Flow Statement	27
Disclosures and Disclaimers	28

Exhibit 1: Hotels distribution per type of business (%)



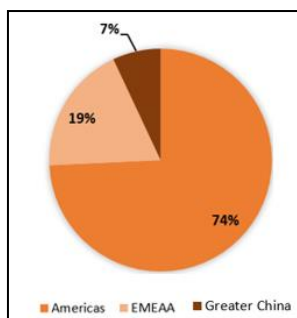
Source: Company data

Exhibit 2: Rooms distribution per geographical region (%)



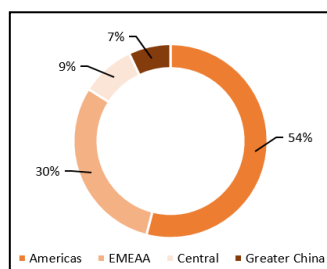
Source: Company data

Exhibit 3: Hotels distribution per geographical region (%)



Source: Company data

Exhibit 4: Revenues per reportable segment (%)



Source: Company data

Company Overview

Headquartered in Denham, Buckinghamshire (England) and founded in 2003, InterContinental Hotels Group (IHG) is one of the world’s leading hotel companies whose main purpose is to provide high-quality experiences to customers all around the world, based on their proposition of “True Hospitality”. In terms of business, the company has three types of business models: (i) franchised, (ii) managed and (iii) owned, leased & managed lease hotels, corresponding to 82.2%, 17.2% and 0.41% of the total number of hotels held by the company – see exhibit 1.

The company operates in more than 100 countries and reports the results according to four segments – Americas, Greater China, EMEAA (which includes Europe, Middle East and Africa) and Central. The first three are considered the company’s geographical regions (Americas region accounts with 61% of the total number of rooms, in second place is EMEAA with 25% and Greater China is the region with the smallest percentage – 14%) – see exhibit 2. Deepening this topic, 74% of Group’s hotels are located in Americas, 19% in EMEAA and only 7% in China – see exhibit 3. Central functions include “costs of global functions including technology, sales and marketing, finance, human resources and corporate services and its main revenues arise from technology fee income”¹. Besides being the region with the highest number of rooms and hotels, Americas region is the one which reports the highest revenue amount, reaching 54% of the group’s total in 2018 – see exhibit 4.

The Group divides his brands in 3 different categories: Mainstream² (operating across the midscale and upper midscale market segments, with 16% of existing global number of rooms and 25% of the official company’s pipeline³), Upscale⁴ (improved service and modern designs to deliver distinct experiences) and Luxury⁵ (in order to enhance loyalty and attract more corporate customers. VOCO and Avid are the most recent brands, both of them launched in 2018. Furthermore, Regent Hotels’ brand was acquired by IHG also in 2018.

¹ According to IHG 2018 Annual Report

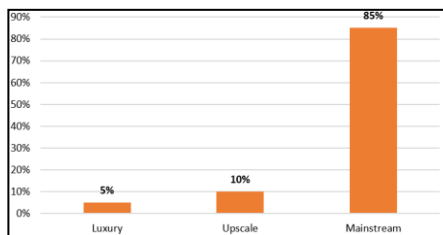
² Brands: Holiday Inn, Holiday Inn Express, Holiday Inn Club Vacations, Candlewood Suites, Staybridge Suites, Avid Hotels.

³ Supplementary Information report (30/09/2019): <https://www.ihgplc.com/-/media/ihg/files/results/2019/q3/q3-2019-supplementary-information.pdf>

⁴ Brands: Crowne Plaza, VOCO, HUALUXE, Even Hotels, Hotel Indigo.

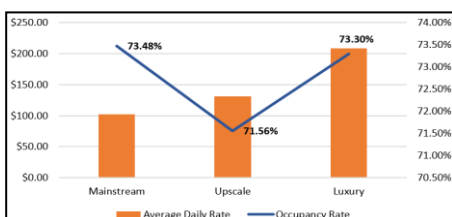
⁵ Brands: Six Senses, Regent, InterContinental, Kimpton.

Exhibit 5: Hotels distribution per category (%)



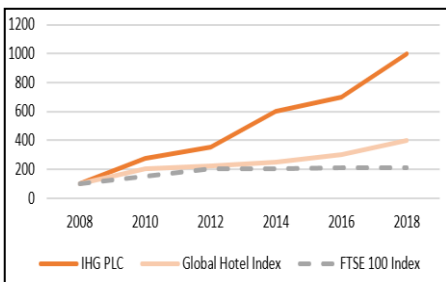
Source: Company data

Exhibit 6: ADR (\$) and Occupancy Rate per hotel categories (in 2018)



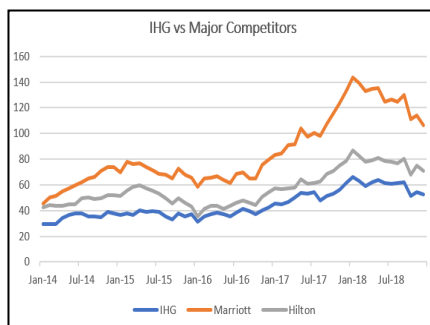
Source: Company data and Analysts

Exhibit 7: Comparison between indexes' performances, in £ (2008 – 2018)



Source: Company & Reuters

Exhibit 8: Share price evolution, in \$ (Jan 2014 – Sep 18)



Source: Bloomberg

In comparable terms, the majority of hotels are from the Mainstream category (85% of the total) and the most exclusive one (Luxury) accounts for the lower percentage (5%) – see exhibit 5.

The Average Daily Rate (ADR)⁶ and Occupancy Rate⁷ are both important metrics that need to be analysed in order to understand the financial contribution of each hotel category for the Group's performance. It was verified the highest Occupancy Rate in Mainstream and Luxury categories (73.5% and 73.3%, respectively). In average and all over the world, the Occupancy Rate of IHG's hotels is about 72.8%. In terms of ADR, Luxury is the category with the highest revenue per room sold, as expected (\$208.2). Mainstream hotels verified an average ADR of \$102.0. So, we can assess that one room from a Luxury hotel can generate more than twice revenue amount than a room from a Mainstream hotel – see exhibit 6.

The company reported \$27.4 bn as total revenues, in 2018 (an increase of 6.6% since the previous year) and counted with +35,000 employees distributed among all the different geographies.

InterContinental Hotels Group PLC is a member of FTSE 100 Component, an index of the top 100 companies listed on the London Stock Exchange (LSE) that have the highest market capitalization. In exhibit 7, it is possible to observe that the company performed an analysis comparing the evolution of IHG historical TSR⁸ index vs global hotel index (that comprises the evolution of the major players on the industry) vs FTSE 100 Component. It is interesting to conclude that from 2008, the IHG's stock is performing much better than the other aggregated indices, meaning that historically shareholders had higher returns by investing their money in IHG stocks individually. It is known that IHG has adopted expansionist measures in order to increase the company's value (such as the construction of new hotels in all geographical segments, resulting in higher revenues and profits for the Group) in the last years. Its progressive overall growth resulted in a sustainable share price and TSR increase during the last decade.

We decided to do a comparison between the IHG's (traded in dollars) and the biggest hotels companies' share prices – see exhibit 8. It is possible to conclude that all of the companies' share prices have been following the same trend, decreasing and increasing in identical periods. Since 2014, Marriott⁹ is the company whose share price is diverging the most, with a huge increase from the

⁶ ADR = rooms revenues / number of room nights sold

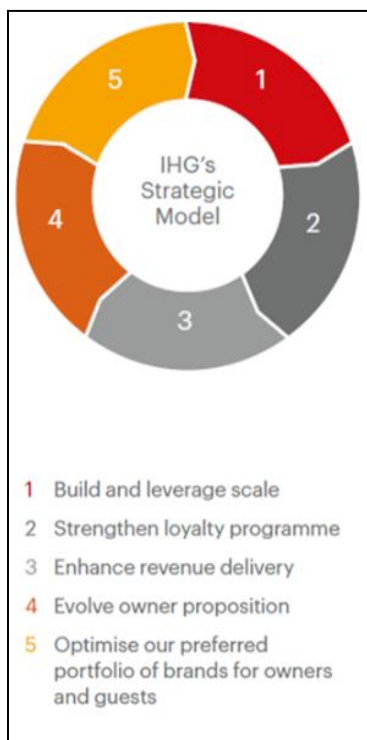
⁷ Occupancy rate = occupied rooms / total number of available rooms

⁸ Total Shareholder Return

⁹ Marriott International – Annual Report (2018): <https://marriott.gcs-web.com/static-files/8799734e-b9e0-4e53-b194-7bd24a381118>

last semester of 2016 until beginning of 2018. According to Financial Times¹⁰, the beginning of 2014 was not the best of the IHG – after experienced the largest activities expansion policy between 2010 and 2013, the Group started to slow down in terms of growth, which had an impact of decreasing the stock price in the beginning of 2014. Since that moment, a price increase trend was verified until today, not only for IHG but also for the two illustrated competitors (with a significant increase in share prices in July 2017). It can be justified because of an overall rise in Occupancy Rates in EMEA hotels in this period, boosting growth in revenue and profit amounts¹¹. In USA, the justification is related to the dollar strength verified in this period of time: destinations located in Americas increased their demand due to a favourable monetary environment for dollar¹², which had a positive impact in lengths of stay and in the amounts spent by tourists, increasing hotels revenues and profits.

Exhibit 9: IHG Strategic Model



Source: IHG 2018 Annual Report

Strategy and Business Models

“Our strategy for high-quality growth” is the first sentence that appears in the IHG’s 2018 strategic report, which can be divided in two main words: quality and growth. In fact, the company’s board established a well-designed strategy and is really committed to achieve the proposed targets IHG is concerned about shareholders’ returns, so its operations should be well managed and controlled so that positive financial results can be raised. In that way, there will be a positive impact for shareholders. However, one of the most important goals for the Group is to achieve those objectives in a sustainable (bearing in mind possible threats, such as the increasingly usage of online travel agents) and consistent way (through a long-term growth strategy in all geographical regions). The IHG strategic model is composed by five main objectives, which enables the Group’s success in its sector and to be committed with the “True Hospitality” principle – see exhibit 9 and 10.

Exhibit 10: IHG Corporate Values



Source: IHG 2018 Annual Report

Inherent to its strategic model, IHG core operations are divided in the three types of IHG’s business models: (i) Franchised¹³, (ii) Managed¹⁴ and (iii) Owned, Leased and Managed Lease. The first two business models compose the Fee-Business group.

¹⁰ Financial Times (February 2014): <https://www.ft.com/content/9845d31a-987f-11e3-8503-00144feab7de>
¹¹ Hotel Management (January 2018): <https://www.hotelmanagement.net/revenue-management/mea-hotels-record-strong-year-end-performance-december-2017>
¹² Market Realist (2017): <https://marketrealist.com/2017/03/how-has-the-hotel-industry-performed-in-2017/>
¹³ Hotels whose ownership and operations are assumed by parties distinct from the hotel brand, paying fees to the company for the use of the brand.
¹⁴ Hotels whose operations are assumed by a party distinct from the hotel owner, paying management fees and, if that hotel uses a third-party brand name, also needs to pay fees to that third-party.

Each business model has its own process in order to calculate revenues. In the Franchised cases, revenues¹⁵ are influenced by the Royalty Rate, Revenue per Available Room (RevPAR) and number of rooms. IHG receives a fixed percentage (Royalty Rate – approximately 5%) of the room revenue following a guest staying at the hotel.

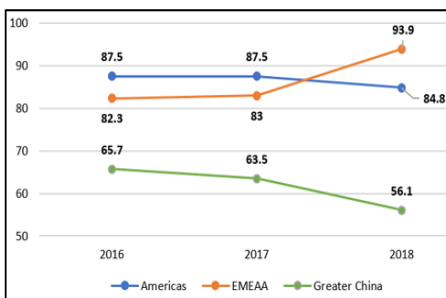
Revenues from Managed hotels are reported by IHG in a similar way as Franchised ones – beyond the fixed percentage applied to the room revenue, Managed hotels also need to distribute a proportion of the hotel’s profit. Despite of having different approaches to calculate revenues, we decided to calculate both revenues from Franchised and Managed in the same way, following the calculation method of Franchised hotels. The reason why we used this assumption is that the proportion of profits distributed from Managed hotels are different from hotel to hotel, depending on each specific contract – there is no fixed percentage. Based on that, we considered this to be the better approach to made in order to perform a more accurate forecast.

Revenues from Owned, Leased and Managed Lease hotels correspond to the total room revenue verified, since both management and operations are insured by IHG.

Revenue per available room (RevPAR¹⁶) is one of the key performance metrics in the hotels industry and will be used to calculate the revenues from fee-business. We can assess this by the last three years’ trend – RevPAR remained almost constant from 2016 until 2017 and started to decrease in Americas and Greater China (in 2018), however, in EMEAA it was observed a considerable increase (approximately + \$10). In aggregated terms, the IHG’s consolidated RevPAR suffered an increase of 1.6% (weighting RevPAR of each segment with the revenues generated in each region), which is in line with a PwC study¹⁷ – see exhibit 11.

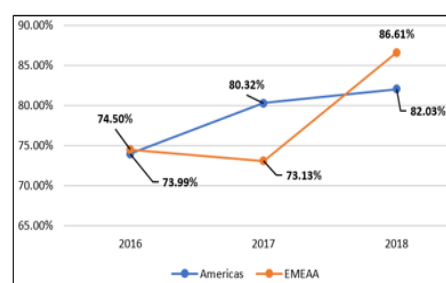
In terms of Occupancy Rate (used to calculate revenues from owned hotels), it was verified a decrease (-1.38 basis points) in EMEAA and an increase (+6.33 basis points) in Americas in 2017 – see exhibit 12. In 2018, both regions evidenced an increase in this value drivers – the rate of IHG hotels located in Americas slightly increased (+1.71 basis points), and EMEAA faced a notable increase (+13.49 basis points), which had a positive impact in the reported revenues from owned hotels.

Exhibit 11: Evolution of RevPAR per regions, in \$ (2016 – 2018)



Source: Company data & Analysts

Exhibit 12: Evolution of Occupancy Rate per regions, in % (2016 – 2018)



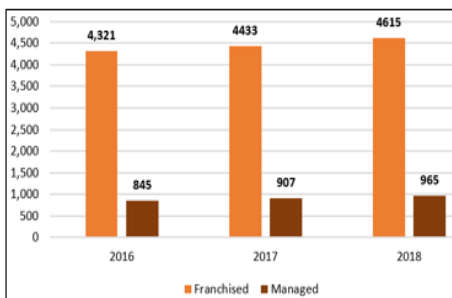
Source: Company data & Analysts

¹⁵ Revenue = Royalty Rate x RevPAR x # rooms

¹⁶ RevPAR = rooms revenue / room nights available = Occupancy Rate x ADR

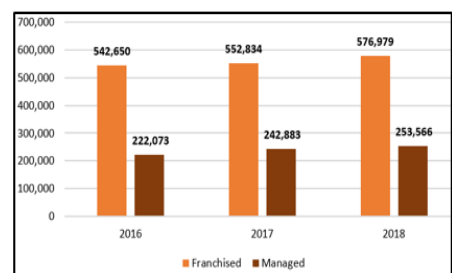
¹⁷ PwC, 2019 – “Room Supply Surge Checks Growth Pace”

Exhibit 13: Evolution of Hotels Number in Fee Business (2016-2018)



Source: Analysts

Exhibit 14: Evolution of Rooms Number in Fee Business (2016-2018)



Source: Analysts

Exhibit 15: Evolution of revenues per business model (in millions)



Source: Analysts

In aggregated terms, the number of hotels in fee business is progressively increasing. In 2018, more than 99% of the Group’s total hotels were classified in fee business, having less than 1% (23 hotels) as owned, leased and managed lease. In terms of growth, in 2017 and 2018 the number of franchised hotels verified an increase of 2.59% and 4.11%, respectively. Managed hotels faced a growth of 7.33% and 6.40% in 2017 and 2018, respectively. Consolidating, the fee business model grew at 3.37% and 4.49%, in 2017 and 2018 respectively. Given the fact that the total number of hotel is increasing, it will have an impact in the number of rooms, which will impact revenues – see exhibit 13 and 14. The growth in number of fee business hotels originated an increase of 1.88% and 4.37% in the number of rooms in 2017 and 2018, respectively. In the Managed cases, the growth in hotels was responsible for an increase of 9.37% and 4.40% in 2017 and 2018, respectively, in the number of rooms.

Fee business generates the majority of IHG revenues (76.9% in 2018). It was verified a 3.76% and 7.76% growth in those revenues in 2017 and 2018, respectively. Despite revenues from Owned, Leased and Managed Lease hotels accounts for less than 20% of the Group’s total, in 2017 the amount grew 3.85% and 27.35% in 2018. In that way, we can conclude that the growth in the Group’s revenues are in line with the evolution of the main value drivers – see exhibit 15.

In order to perform an accurate forecast for number of hotels and rooms, it is important to analyse the company’s pipeline¹⁸ - see exhibit 16. We can assess that IHG will increase the fee business number of hotels in 1,940 (1,414 will be franchised and 526 managed). It seems that IHG will not invest in the building of owned, leased and managed lease hotels, having only one in pipeline. In an aggregated point of view, Americas is the region where the largest number of hotels are being constructed (1,139 – corresponding to 58.68% of the pipeline). It is estimated that within 10 years IHG accomplishes the current pipeline, increasing the number of hotels in 30.64% in franchised, 54.54% in managed and 3.57% in owned.

Exhibit 16: IHG Pipeline as at 30th September 2019

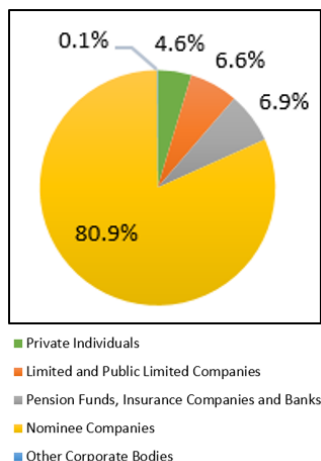
	Franchised		Managed		Owned, Leased & Managed Lease		Total	
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms
Americas	1,090	110,699	49	7,581	0	0	1,139	118,280
EMEA	162	27,134	242	56,920	1	155	405	84,209
Greater China	162	28,023	235	58,623	0	0	397	86,646
Total Pipeline	1,414	165,856	526	123,124	1	155	1,941	289,135

Source: IHG Supplementary Information Report (Q3)

¹⁸ Hotels (and rooms) that will enter in an hotel company in the future. In the pipeline are included the hotels whose contract has been signed and respective fees paid.

Shareholders Structure and Dividend Policy

Exhibit 17: Shareholders structure in 2018 (%)

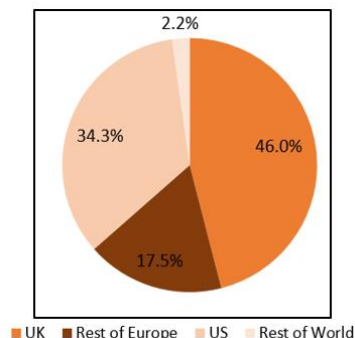


Source: Company data

The IHG's are divided in five different categories: (i) Nominee Companies, who have the biggest percentage of the company's ordinary shares. (ii) Limited and Public Limited Companies and (iii) Pension Funds, Insurance Companies and Banks accounts for 6.6% and 6.9%, respectively. The smallest categories of IHG's shareholders are (iv) Private Individuals and (v) Other Corporate Bodies, holding 4.6% and 0.1%, respectively – see exhibit 17.

According to Zouhayer Mighri¹⁹, the presence of institutional investors (such as Nominee Companies, Pension Funds, Insurance Companies and Banks) in a company's shareholders structure has a positive impact on ROE²⁰, due to the effectiveness of leaders' control. In that way, the current IHG shareholders structure (the majority of them are institutional investors) results in a positive outcome for the company's value. The majority of the issued share capital²¹ is held by shareholders from UK's jurisdiction (46%). US is the second region with the highest percentage, 34.3% – see exhibit 18.

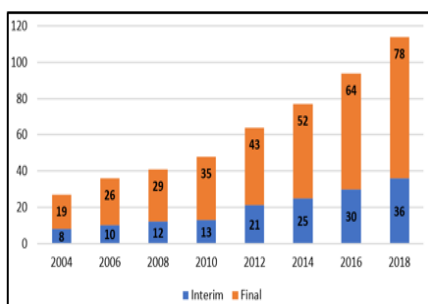
Exhibit 18: Distribution of Shareholders in the world, in 2018 (%)



Source: Company data

According to the Board, the capital allocation approach is reviewed every fiscal year in order to maintain an accurate balance sheet and a sustainable investment grade credit rating. It can be assessed through the IHG's dividend policy: the Board proposed a final dividend of 78.1 cents (€) per ordinary share in 2018 to be paid on 14th May 2019, resulting in a full-year dividend of 114.4€, which is calculated by summing the interim (paid to shareholders during the year – semi-annual in UK and trimestral in USA) dividend (36.3€) with the final dividend. By analysing the evolution of both dividends, it was verified, in 2018, that the interim was 4.5x higher and the final was 4.1x higher compared to 2014, resulting in an increase of 322.22% [verified 11% of CAGR - compounded annual growth rate] of the full-year IHG's dividend (comparing 2018 and 2014 dividends' values) – see exhibit 19.

Exhibit 19: Dividend Progression, in € (2004 - 2018)



Source: Company data

Regarding the Group's dividend policy, it will be paid \$500 million special dividend at 29th January 2019.

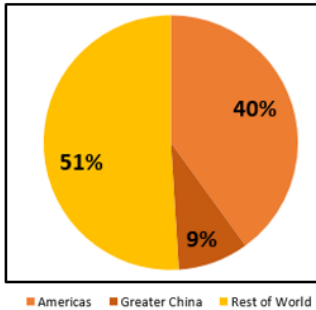
¹⁹ Journal of Financial & Business Affairs (2016): <https://www.omicsonline.org/open-access/ownership-structure-and-corporate-performance-the-case-of-listed-tunisian-firms-2167-0234-1000222.php?aid=82012>

²⁰ Return on Equity

²¹ From annual report: "The geographical profile presented is based on an analysis of shareholders (by manager) of 40,000 shares or above where geographical ownership is known".

Industry Analysis

Exhibit 20: Distribution of hotels industry revenues per region (%)



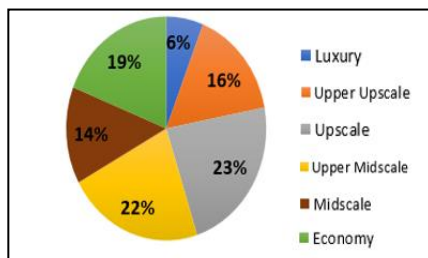
Source: STR, Inc

Hotels industry generated \$525bn in revenues (values of 2018), accounting with more than 18 million rooms in the entire world. Hotels are divided in two different categories, in terms of ownership: branded (54% of rooms) and independent (46% of rooms).

Geographically, the industry is intensified in Americas region (40% of the market) and it is important to notice that nearly 9% of the market revenues are born in Greater China – see exhibit 20.

In terms of categories, the industry is divided in six categories, according to the price level. In 2018, the majority of the existing hotels were from the Upscale (23%), Upper Midscale (22%) and Economy (19%). The Luxury category is the smallest one, with a weight of 6% in the total industry – see exhibit 21.

Exhibit 21: Division of hotels per price categories (%)

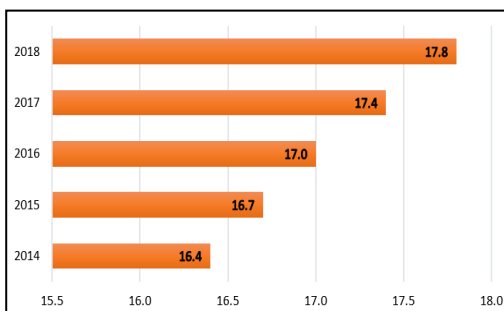


Source: STR, Inc

We can easily assess in exhibit 22 that the rooms supply has been increasing since 2014, meaning that, in global terms, the industry is growing and new hotels are being constructed all over the world. Consequently, it means that the hotels industry is really attractive and has a lot of opportunities for the people who desires to invest on it, otherwise the total rooms supply would not have grown in the latest years.

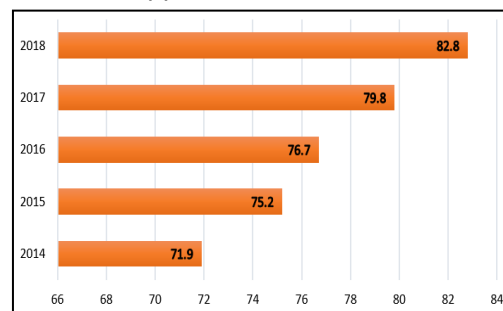
This industry was growing in ten consecutive years, however, as analysed by Deloitte²², the projections for the year of 2019 suggest a slight loss in the most relevant performance metrics, such as ADR (-0.1 percent), RevPAR (-0.5 percent) and Occupancy Rate (-0.3 percent), which can be considered an alert signal for the companies of the sector – see exhibit 23. In that way, we predict an aggregated RevPAR of \$85.50 for 2019.

Exhibit 22: Evolution of aggregated rooms supply, 2014 - 2018 (million rooms)



Source: STR, Inc

Exhibit 23: Evolution of aggregated RevPAR, 2014 - 2018 (\$)



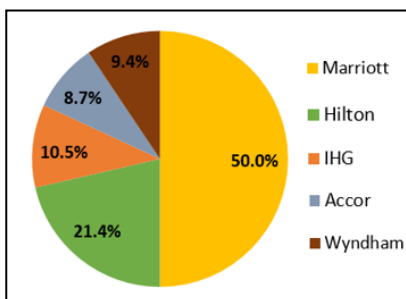
Source: STR, Inc

²² “2019 US Travel and Hospitality Outlook”, Deloitte (2019)

Competitors

The hotels industry is very competitive, due to being attractive for possible joiners, so the “giants” that are already established and settled in all geographies have the ambition to achieve higher level of revenues in order to maintain or increase their market shares.

Exhibit 24: Division of major players' market share in 2018 (%)

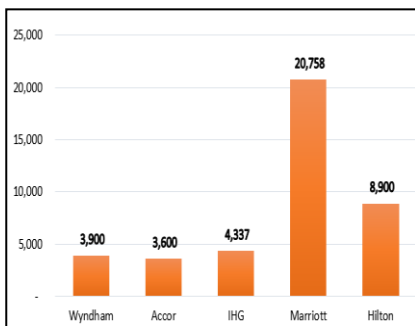


Source: Bloomberg

IHG is in the list of top five hotel companies, in terms of presence in the sector's market. The remaining four are Marriott, Hilton, Wyndham and Accor. These five groups are holders of 25% of the total industry's market share (an increase of 6 basis point since 2012).

By analysing the exhibits 24 and 25, it is possible to conclude that Marriott is the industry company with the highest market share (50%) between the five major players. Then comes Hilton and IHG with 21.4% and 10.5%, respectively. In the end, Wyndham and Accor (9.4% and 8.7% of the market share, respectively). Furthermore, we can assess that Marriott generated the highest revenues in 2018 (20,758 million \$), 6.5 times higher than the average of the remaining four.

Exhibit 25: Revenues in 2018 (\$ million)

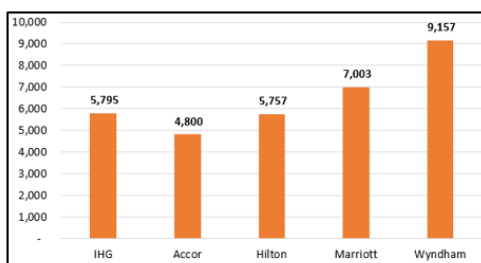


Source: Bloomberg

Despite being the company with the higher revenue amount, Marriott is not the one with the largest number of hotels – this title belongs to Wyndham, with 9,157 hotels – see exhibit 26.

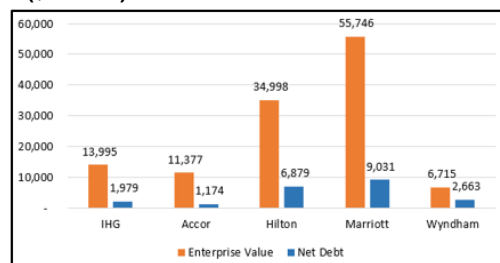
In what concerns the total value of those companies, Marriott is the one that verified a highest Enterprise Value in 2018 (55,746 million \$), 3.32 times above the average of the remaining four. IHG is ranked with the third larger EV compared to the top-five of its sector (13,995 million \$) – see exhibit 27.

Exhibit 26: Number of Hotels in 2019



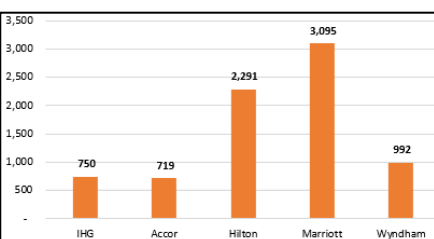
Source: Companies Data

Exhibit 27: Enterprise Value and Net Debt in 2018 (\$ million)



Source: Bloomberg

Exhibit 28: EBITDA in 2018 (\$ million)

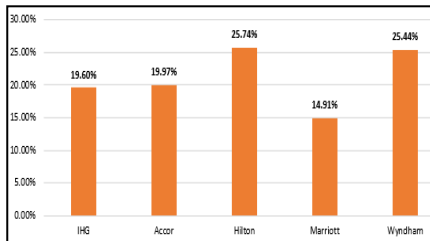


Source: Bloomberg

In terms of net debt analysis, the company with the higher value is also Marriott (9,031 million \$). However, Wyndham presented the biggest ratio between net debt and EV (39.66%). IHG verified a ratio of 14.14%, which is positive relatively to its peers, given that the average ratio of these companies is approximately 20%.

IHG is positioned in the fourth position concerning 2018 EBITDA values (750 million \$) – see exhibit 28. Through the EBITDA/Revenues ratio analysis, we can infer that all the companies had a stable ratio (21.13% on average), meaning that in terms of relative profitability, they seem to be approximately consistent. However, Marriott (the company with the highest EBITDA and Revenues values) verified the lowest weight of EBITDA in total reported Revenues, meaning that is the one which incurred in highest costs – see exhibit 29.

Exhibit 29: EBITDA/Revenues in 2018



Source: Bloomberg

By now, we can conclude that IHG is one of the most relevant hotels company. In that way, it is important to set the principal competitive advantages, so we can understand why IHG reached the excellence and reputation in its sector, being considered one of the top-five companies. We identified some aspects that differentiate IHG from the remaining hotels companies:

- (1) Loyalty programme – IHG is the company with the highest number of members worldwide, accounting with 92 million, whereas Hilton has 51 million and Marriott has 54 million. By having an attractive and differentiated loyalty programme, the customers’ needs are satisfied and relationships between company and guests are fortified.
- (2) Holder of the largest hotel brand – Holiday Inn brand is the one with the largest number of properties in the world (4,112 hotels), and also one of the most known by tourists.
- (3) Huge brand value – with more than 10 brands, IHG is one of the hotel companies with the highest number of brands known worldwide. They are constantly creating brands (such as VOCO and Avid in 2018).
- (4) Holder of a high number of hotels and hotels under construction – the Group is the holder of 5,795²³ hotels spread all over the world, having 1,941 in construction.

Future Trends and Challenges

Asset-Light Business Model

IHG’s revenues are reported according to two different designations: revenues from fee-business hotels and revenues from Owned, Leased and Managed Lease hotels. The first group of hotels is characterized by an asset-light strategy – in this type of business, are included the Franchised and Managed hotels. The group of Owned, Leased and Managed Lease hotels is characterized by an

²³ Values as at 30th September 2019

asset-heavy strategy – in this type of business, are included Owned²⁴ and Leased²⁵ hotels. The second type of hotels’ business incurs in more costs for the owners, whilst the first one provides faster growth with less invested capital.

By analysing the 2018 business structure of the major sector players, we verify they are following similar models – certain part of their hotels belong to Franchised or Managed categories, and a minority is still owned by the company – see exhibit 30. More specifically, on average 83.58% of the total number of hotels are franchised, 15.79% are managed and less than 1% are owned. This means that all of the presented companies are following an asset-light strategy, preferring fee-business hotels rather than owned.

Exhibit 30: Number of Hotels per business model in 2018

	Franchised	Managed	Owned, Leased & ML	Total
Marriott	4905	2035	63	7003
Hilton	4947	689	68	5704
Wyndham	8717	438	2	9157
IHG	4615	965	23	5603

Source: Companies data & Analysts

During the last three years the number of rooms and hotels increased in all geographies (in Fee Business). Americas is the reportable segment that accounts for the highest number of hotels (54% of the total IHG hotels) – see exhibit 31. In 2018, this region achieved the largest number of rooms in the last decade (510,129), namely due to the increase of the number of Holiday Inn and Holiday Express brands. Moreover, it was launched Avid hotels in this region. Luxury and Upscale categories also suffered an increase in volume.

Exhibit 31: Evolution of number of Hotels and Rooms per geography, per business model (2016 – 2018)

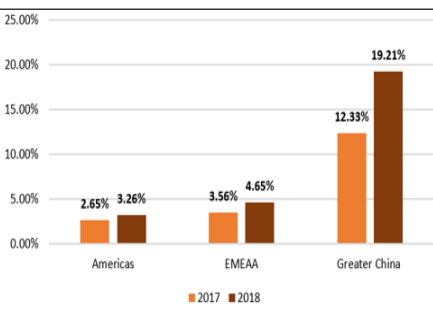
		Fee Business			Owned, Leased & ML		
		2016	2017	2018	2016	2017	2018
Americas	# Hotels	3,919	4,023	4,154	6	6	7
	# Rooms	486,168	495,635	507,906	1,825	1,825	2,223
EMEA	# Hotels	955	989	1,035	2	2	16
	# Rooms	185,533	198,543	207,326	587	533	3,773
Greater China	# Hotels	292	328	391	-	-	-
	# Rooms	93,022	101,539	115,313	-	-	-

Source: Companies data & Analysts

²⁴ Operations and brand are from the owner property, bearing all costs and benefits from activities.

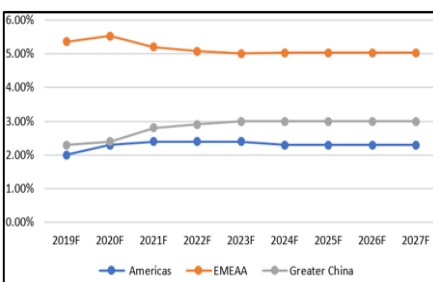
²⁵ Similar to the definition of owned, however the owner-operator has not outright ownership of the hotel – he leases it from the ultimate owner.

Exhibit 32: Fee business hotels growth rate (2017-2018, IHG)



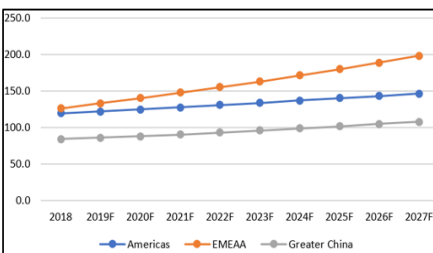
Source: Company data & Analysts

Exhibit 33: Forecasted Inflation Rate (%)



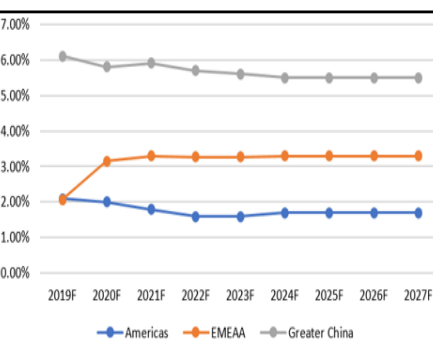
Source: IMF

Exhibit 34: ADR based on forecasted Inflation rate (in \$)



Source: Company Data, IMF and Analysts

Exhibit 35: Forecasted Real GDP Growth (%)



Source: IMF

For EMEAA, it is important to highlight that the number of signings increased by more than 20%. The number of Fee Business hotels is increasing (2017: +3.56% | 2018: +4.65%) – see exhibit 32. However, the number of Owned, Leased and Managed Lease hotels remained constant between 2016 and 2017, increased by 14 the number of this hotels’ type in 2018.

Greater China is the geographical region with fastest growth. In 2018, a record number of signings and openings were performed. It is the most recent region to be explored by IHG and will be the one with the highest number of hotels in the future years, according to IHG strategic plan. It is important to notice that there are only Fee Business hotels in Greater China. We can conclude that the total number of hotels (in Fee Business) has been increasing in the last three years (2017: 12.33% | 2018: 19.21%), an evidence of the expansion to Asian markets.

Economic Evolution

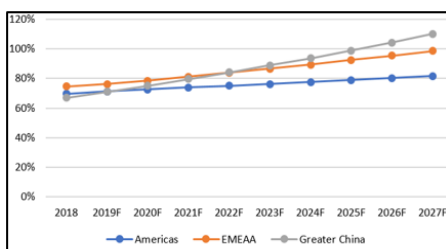
One of the most important variables which influences and models future prices is inflation²⁶. According to data provided by IMF – see exhibit 33 –, inflation rate will increase in all IHG geographical regions (between 2019 and 2020), starting to decrease until 2022 in EMEAA (the region with highest verified inflation rate – 5.53% is the forecasted inflation rate for 2020). In Americas and Greater China, inflation rate is expected to increase until 2021, maintaining approximately constant from there on. ADR is forecasted based on expected inflation rate, which will ultimately influence RevPAR.

Inflation has a positive relationship with prices – see exhibit 34. We can conclude that in 2018 Americas and EMEAA had a really close ADR (\$119.50 and \$126.33). However, and since it is predicted that inflation rate will be higher in EMEAA, the aggregated ADR of this region will grow more than in other regions.

Occupancy rate is forecasted based on expected real GDP growth. In Americas’ case, it is expected that real GDP growth rate decreases until 2022. Forecasts for EMEAA suggest that in 2019 will have the same growth as Americas region, however, between 2019 and 2021 will diverge from Americas, increasing the growth. Greater China will slightly decrease the real GDP growth rate until 2024. IMF forecasts that from 2024 onwards the growth trend is to remain constant for all mentioned regions, with values rounding 1.70%, 3.30% and 5.50% for Americas, EMEAA and Greater China, respectively – see exhibit 35.

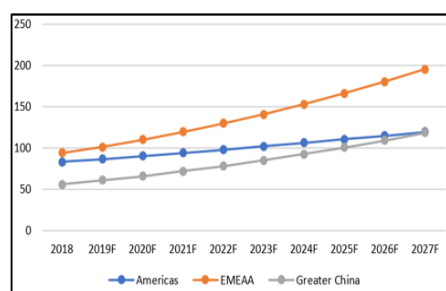
²⁶ IMF: average consumer prices (annual percent change)

Exhibit 36: Occupancy rate based on forecasted Real GDP Growth (%)



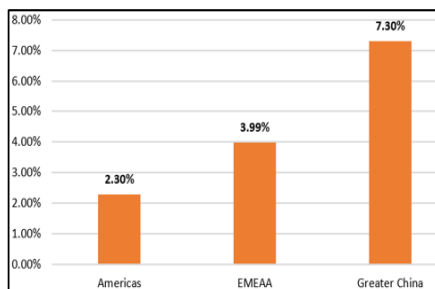
Source: Company Data, IMF and Analysts

Exhibit 37: RevPAR based on forecasted real GDP growth and Inflation (in \$)



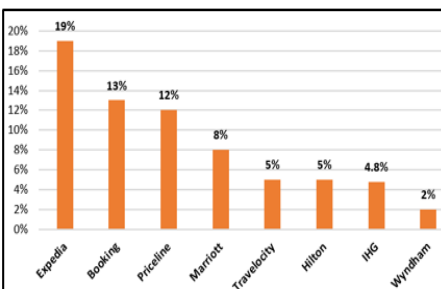
Source: Company Data, IMF and Analysts

Exhibit 38: Forecasted Contribution of T&T sector to Real GDP in 2019 (%)



Source: WTTC

Exhibit 39: Online hotel booking market share in 2017



Source: Hitwise

Since real GDP is growing in all regions, it is expected that the respective occupancy rates will also increase. Greater China is the region with the highest forecasted real GDP growth rate, meaning that hotels from this region will suffer a higher increase in occupancy rate (+43 basis points in 2027 compared to 2019). However, this huge increase does not seem reasonable, so we did some adjustments in our valuation model based on predicted online travel agents (namely Airbnb) impact. Based on IMF forecasts for real GDP growth rate, Americas is the region with the lowest increase on occupancy rate, between 2019 and 2027 (2019F: 69.68% | 2027F: 81.57%) – see exhibit 36.

It is also important to analyse how RevPAR is influenced according to the effects of real GDP growth rate and inflation. In that way, the occupancy rate and ADR evolutions (forecasted through real GDP growth and inflation, respectively), will have a positive impact in RevPAR – see exhibit 37. Analysing both effects at the same time, we can conclude that RevPAR is expected to grow 107.37% in EMEAA (due to increase of 56.99% in ADR and 32.09% in Occupancy Rate), 111.12% in Greater China (due to increase of 28.46% in ADR and 64.38% in Occupancy Rate) and 43.66% in Americas (due to increase of 22.71% in ADR and 17.07% in Occupancy Rate).

According to WTTC²⁷, Tourism & Travel sector is one of the most vital for national and regional GDP health. By analysing the real growth of the Contribution of Tourism & Travel sector to GDP²⁸, in 2019, it is expected that the industry contribution to GDP increases, on average, 4.53%. The region with the highest forecasted T&T contribution to GDP is China (7.30%) and the smallest one is Americas (2.30%) – see exhibit 38.

Online Travel Agents (OTAs)

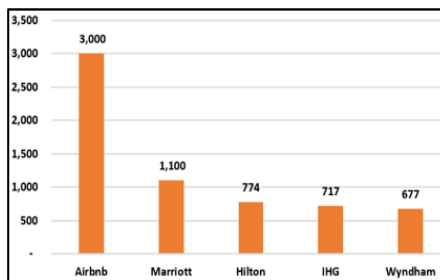
Online travel agents (OTAs) are websites where is possible to buy products or services²⁹ related to tourism. Despite of the hotels' companies having their own online booking systems, OTAs can play a very important role in terms of opportunities for hotels and distribution, allowing tourism companies to reach a wider audience. In exhibit 39, it is possible to assess that the majority (approximately 50%) of online hotel booking were done via OTAs (such as Expedia, Booking.com, Priceline.com and Travelcity.com) in 2017.

²⁷ World Travel & Tourism Council (2019) – "Travel & Tourism – Economic Impact"

²⁸ Ratio between the part of real GDP from T&T (Travel and Tourism sector) and the total geographical GDP generated.

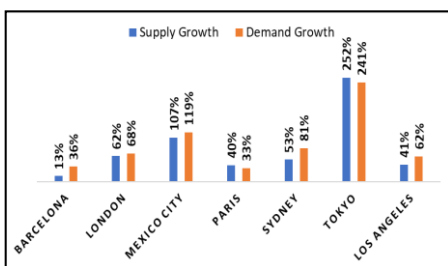
²⁹ Such as hotels stays, flights, tourism packages and car rentals.

Exhibit 40: Number of rooms/listing disclosure online in 2016 (in thousands)



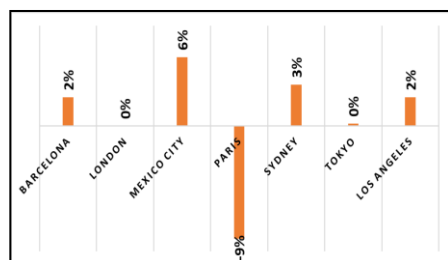
Source: STR

Exhibit 41: Airbnb Supply and Demand Growth in 2016 (%)



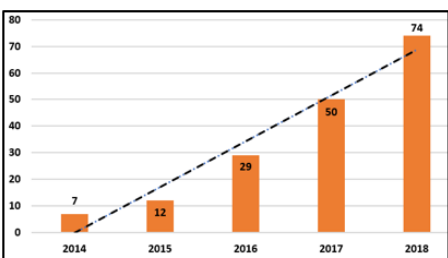
Source: STR

Exhibit 42: Hotels Demand Growth in 2016 (%)



Source: STR

Exhibit 43: U.S. Airbnb demand growth (number of nights booked, in million)



Source: Hans Detlefsen

Effectively, when using an OTA, users make bookings more quickly and in any part of the world, for any country they wish to visit. OTAs charge fees to companies in order to publicize their products. Those fees vary from service and company, but normally represent a percentage of the total amount paid by the customer. For example, Booking.com charges a commission between 10% and 15% and Expedia’s fees constitute approximately 22% of total amount paid.

According to RevFine³⁰, there is a trade-off for hotels’ companies when they decide to publicize their products in OTAs – these websites will promote hotels’ stays, but it is a quite expensive method.

Despite the majority of OTAs help hotels to attract more customers, having a positive impact on their performances and results, Airbnb represents one of the biggest threats to hotels industry. Being considered one of the most important OTAs in progressive expansion worldwide, we decided to analyse its impact on hotels value drivers, which will lead to a negative impact, according to several studies on this matter.

In terms of online market size, Airbnb accounted with 3 million listings³¹ in 2016, which represents a number higher than the combination between the three major players in hotels’ industry (Marriott, Hilton and IHG), with a total number of online available-for-stay rooms of 2.6 million – see exhibit 40.

According to its annual report³², more than 50 million people bought stays in Airbnb since 2010. Airbnb was valued at \$38 billion in 2019, an increase of 22.6% since its 2015 valuation. By analysing exhibit 41, we can assess that in all presented cities (except Sydney and Tokyo), 2016 Airbnb demand growth was higher than the respective supply growth (this means a positive business environment for Airbnb expansion). On the other hand, 2016 hotels’ demand growth was really lower when compared with Airbnb values – see exhibit 42. In aggregated terms, exhibit 43 illustrates an example of Airbnb nights booked evolution between 2014 and 2018, in U.S. During those four years, the number of nights booked in Airbnb grew 957%. We can conclude that Airbnb is increasing its popularity among communities worldwide, so hotels demand is negatively affected by this OTA, representing a really important threat for hotels.

According to Tarik Dogru³³, Airbnb is expected to impact significantly hotels’ occupancy rates, RevPAR and revenues. Another study conducted by EHL³⁴ suggests that the higher quality in Airbnb listings has a negative impact on hotels’ performance (due to decrease on RevPAR). In order to incorporate this effect in

³⁰ <https://www.revfine.com/online-travel-agents/>

³¹ Such as homes, shared homes and rooms, individual rooms.

³² Summer Travel Report (2015)

³³ <https://www.citylab.com/life/2019/05/heres-how-much-airbnb-is-lowering-hotel-prices-and-occupancy/590485/>

³⁴ <https://hospitalityinsights.ehl.edu/airbnb-impact-hotel-trends>

the valuation model, we applied an adjustment factor to Occupancy Rate. In that way, it will be forecasted based on real GDP growth rate, but adjusted for OTAs effects. In exhibit 44 is illustrated such adjustments we made. Occupancy rate (forecasted) is the value driver predicted by real GDP growth for the all IHG’s geographies (fee business case). Occupancy rate (impact of Airbnb) is the one that will be actually used to forecast revenues. The adjustments applied over the forecast period show a reduction on forecasted occupancy rate driven by real GDP growth (-2 basis points per annum in Americas, -4 basis points per annum in EMEAA and -3 basis points per annum in Greater China). We decided to compute a progressive reduction on occupancy rate due to expected future increase of Airbnb users and expansion.

By doing so, we are directly impacting RevPAR, which will impact revenues. The impact on RevPAR will be the same, in percentage, as the ones registered in occupancy rate. By incorporating such impact in the valuation model, we believe we will reach a more accurate and realistic forecast for the most important value drivers and performance metrics.

Exhibit 44: U.S. Expected impact of Airbnb in IHG’s Occupancy Rate and RevPAR for fee business (2019F-2027F)

Occupancy Rate (Forecasted)	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Americas	71%	73%	74%	75%	76%	78%	79%	80%	82%
EMEAA	76%	79%	81%	84%	87%	89%	92%	95%	99%
Greater China	71%	75%	80%	84%	89%	94%	99%	104%	110%
Occupancy Rate (impact of Airbnb)									
Americas	69.6%	69.1%	68.6%	68.1%	67.7%	67.2%	66.8%	66.3%	65.8%
<i>predicted impact</i>	-2%	-5%	-7%	-9%	-11%	-13%	-15%	-17%	-19%
EMEAA	70.8%	69.3%	67.7%	66.2%	64.7%	63.2%	61.8%	60.4%	59.1%
<i>predicted impact</i>	-7%	-12%	-17%	-21%	-25%	-29%	-33%	-37%	-40%
Greater China	63.8%	64.3%	64.9%	65.4%	66.0%	66.6%	67.1%	67.7%	68.3%
<i>predicted impact</i>	-10%	-14%	-18%	-22%	-26%	-29%	-32%	-35%	-38%
RevPAR (Forecasted)									
Americas	\$86.72	\$90.48	\$94.32	\$98.13	\$102.10	\$106.22	\$110.51	\$114.97	\$119.62
EMEAA	\$101.31	\$110.27	\$119.83	\$130.04	\$141.01	\$152.98	\$165.97	\$180.07	\$195.35
Greater China	\$61.06	\$66.16	\$72.02	\$78.33	\$85.20	\$92.59	\$100.61	\$109.33	\$118.80
RevPAR (impact of Airbnb)									
Americas	\$84.79	\$86.15	\$87.62	\$89.11	\$90.62	\$92.07	\$93.54	\$95.04	\$96.56
<i>predicted impact</i>	-2%	-5%	-7%	-9%	-11%	-13%	-15%	-17%	-19%
EMEAA	\$94.28	\$97.26	\$100.01	\$102.73	\$105.44	\$108.25	\$111.13	\$114.09	\$117.13
<i>predicted impact</i>	-7%	-12%	-17%	-21%	-25%	-29%	-33%	-37%	-40%
Greater China	\$54.85	\$56.65	\$58.74	\$60.96	\$63.33	\$65.80	\$68.35	\$71.01	\$73.77
<i>predicted impact</i>	-10%	-14%	-18%	-22%	-26%	-29%	-32%	-35%	-38%

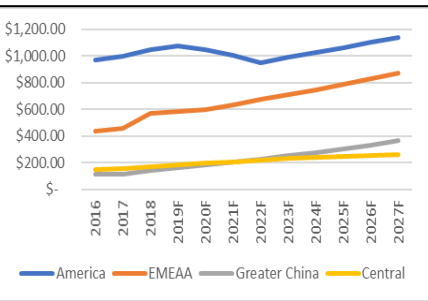
Source: Analysts

Valuation Assumptions

Revenues Forecasts

In the past few years IHG’s revenues have been growing. We forecast that such growing trend will be maintained in the future, however in the Americas’ case it will suffer with the saturation of the market – see exhibit 45.

Exhibit 45: IHG’s forecasted Revenues (\$ millions)

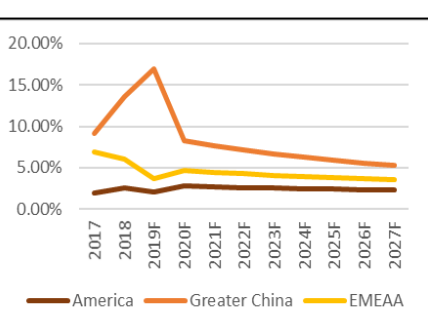


Source: Analysts

The Group have been doing investments in new hotels and new brands like Regent Hotels & Resorts and Voco. Greater China stands out with a growth higher than 10% in the number of rooms, being the IHG’s focus in terms of investments – see exhibit 46. The new brands were launch mostly in areas with high demand and it was an important factor of increase in revenues that had a jump of 12% in 2018 – see exhibit 47.

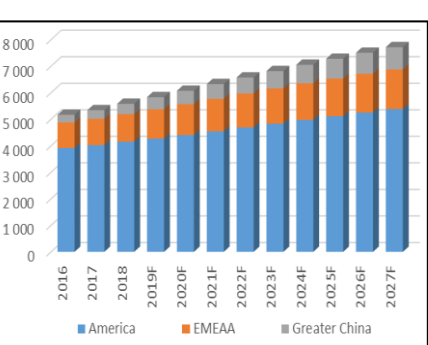
It is the true that tourism market is generally growing in a faster paced than the whole Economy – see exhibit 48 – and this brings new opportunities for companies. Nowadays, costumers have a wider range of options, and it is not possible anymore to hotel groups having massive investments, which would bring a lot of costs. In general, they are trying to create a business based only in franchised and managed hotels rather than own the hotel by themselves. In this way, they can reduce their costs and create more value (not only for shareholders, but also for the remaining stakeholders). IHG is not an exception, all his future investment plans are directly linked to Fee Business – see exhibit 49.

Exhibit 46: Number of Rooms Growth Rate



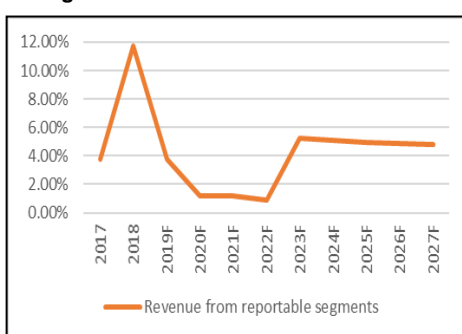
Source: Analysts

Exhibit 49: IHG’s Forecasted Number of Hotels in Fee Business



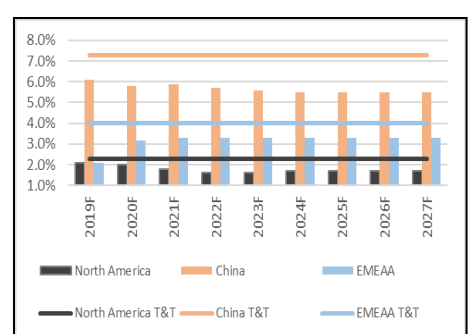
Source: Analysts

Exhibit 47: Revenues from Reportable Segments Growth Rate



Source: Analysts

Exhibit 48: Global GDP Growth and Travel & Tourism GDP Growth

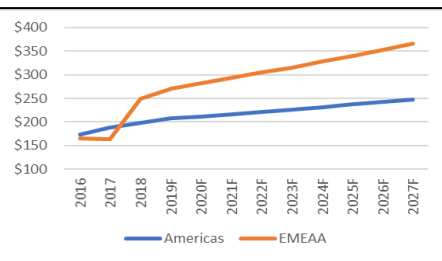


Source: IMF and World Travel & Tourism Council

The revenues will reflect this business options, and of course, we will be able to see the differences in the growing pace between the two types of business.

Revenues from owned, leased and managed leased hotels will have a small and constant growth – see exhibit 50. Although, in EMEAA, the revenues have had a big jump during the last year, it was due to the pipeline that they had, right after this jump.

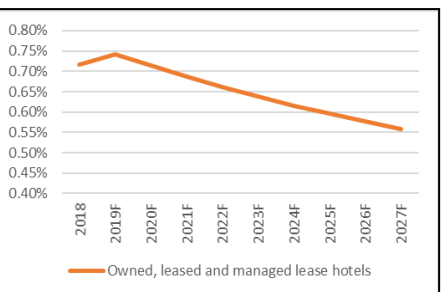
Exhibit 50: Forecasted Revenue from OLML (\$ millions)



Source: Analysts

In this business model we will not see growth in volume, since IHG is not investing in new hotels or brands here – see exhibit 51. Also, occupancy rate is not expected to vary, because IHG is investing in their loyalty program in order to keep their clients' range. So, the growth in revenues will just be impacted by the average revenue per room night. In Americas, the revenue per room night will increase due to inflation rate (around 2.3%) because the Americas' market is the most saturated and stable one. In EMEAA, the revenue per room night will increase due to inflation and market growth. Since the market is still growing, it will be possible to have a higher revenue per room night.

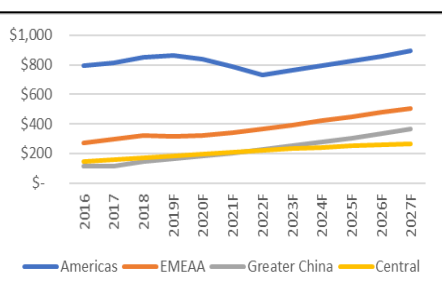
Exhibit 51: Weight of OLML Hotels in the IHG's total # Hotels



Source: Analysts

In fee business, revenues will have a higher growth – see exhibit 52. The Americas' market is saturated, so, even knowing that it will represent the higher number of new hotels, in terms of percentage, Americas will be the one with the shorter space to grow and create value. In our opinion the Economy and the sector are stabilising and the supply is growing, so it will not be able to increase royalty rate. The inflation and the increase in hotel numbers will then be the main growth factors. In EMEAA, the capacity growth will be higher when comparing with Americas due to more and different opportunities that exist in this region. Also, the sector in general is continuously growing which enables this region to be the one that more value will be creating.

Exhibit 52: Forecasted Revenues from Fee Business (\$ millions)



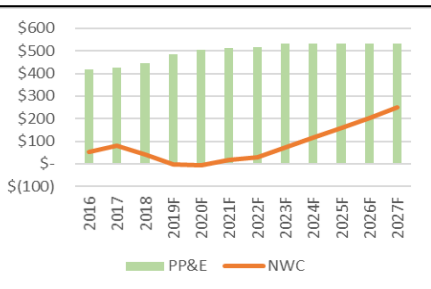
Source: Analysts

In what Greater China concerns, the truth is that its actual weight in the overall group is less than 10%, even though this region has having a huge growth, it is the Group's new bet. Greater China's economy is growing and the tourism sector is not an exception in this geographical region, with a 7.3% of travel and tourism real GDP growth, on average, combining it with the lack of supply, is turning this region very appealing to new investments.

Although the Group is improving its KPIs, the occupation rate will not grow a lot. It is true that tourism market is growing, and the company is taking actions to acquire more clients, however their competitors are also investing and trying to take a position.

PP&E and NWC

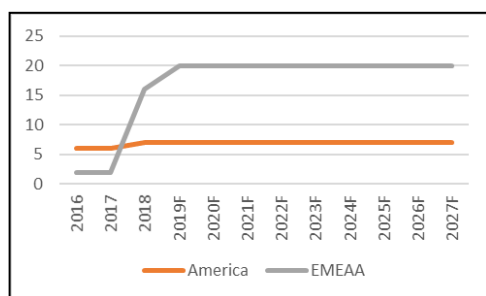
Exhibit 53: Forecasted PP&E and NWC (\$ millions)



Source: Analysts

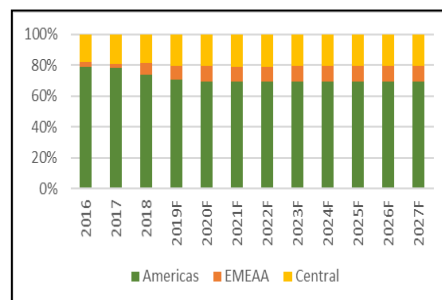
InterContinental Hotels Group is following an asset-light strategy, however their PP&E suffered a slightly increase in 2018 and 2019F – see exhibit 53. Such increase is due to the new Owned, Leased and Managed Lease hotels in EMEAA (and one in Americas), which increased their hotels from 2 to 20. Since 2020 it will be maintaining PP&E approximately in constant levels because of the Group’s strategy – increase number of hotels in Fee Business, and not in the Owned category – see exhibit 54. Splitting IHG’s PP&E by region, we see their investments in 2018 and 2019F in EMEAA, increasing from 3% to 10%, while Central continue representing around 20% – see exhibit 55.

Exhibit 54: IHG’s Forecasted Number of Hotels in OLML



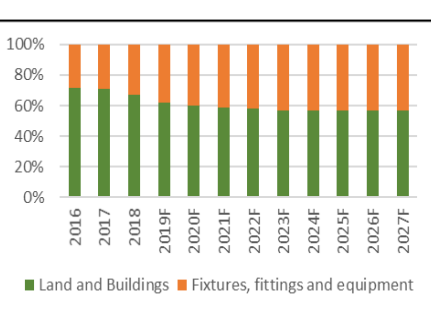
Source: Analysts

Exhibit 55: Forecasted PP&E per Region (%)



Source: Analysts

Exhibit 56: Forecasted PP&E per type (%)

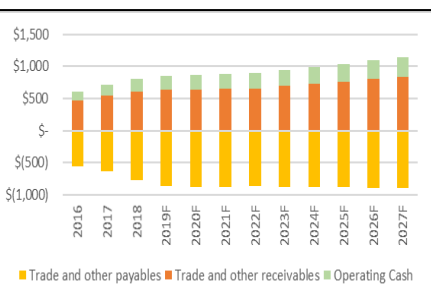


Source: Analysts

To better analyse PP&E, we decided to split it into: Land and Buildings; Fixtures, Fittings and Equipment – see exhibit 56. In this way, we can better understand how PP&E is evolving over time. The weight of Land and Buildings on the total PP&E is decreasing due to the Group’s strategy that relies on fee business. In 2016, 72% of PP&E was Land and Buildings in contrast to the 57% forecasted to 2027. On the opposite side, fixtures, fittings and equipment is increasing due to group’s bet on high technology to match new clients preferences.

Regarding NWC, we should analyse its components: trade and other payables, trade and other receivables and operating cash – see exhibit 57.

Exhibit 57: Items from NWC (\$ millions)



Source: Analysts

Trade and other payables are forecasted based on revenues. Its turnover in terms of days had a significant increase in 2017, however, we expect it to stabilize, reaching 403 days from 2021 onwards, since the Group will not be able to extend more their period to pay to suppliers.

For trade and other receivables, the Group also suffered an increase in turnover period in 2017. We are expecting now that this ratio will keep around the 116 days reached in 2017, since IHG’s policies are trying to limit the increases in period of receivables.

Regarding Operating Cash, it has been growing in the past few years, due to IHG investments and expansion plans, we expect the operating cash to grow in a slower pace until 2021, then the Group should be able to maintain 11.5% of revenues as operating cash, which goes in line with the industry levels.

WACC & Growth Rate

In order to estimate the weighted average cost of capital, we arrived at the cost of equity and cost of debt separately.

We decided to use the Capital Asset Pricing Model (CAPM) to calculate the cost of equity. The Market Risk Premium (MRP) used in CAPM was based on KPMG³⁵ because we believe it is the most appropriate one. As Risk-free, we used the US 10Y Government Treasury Bonds, extracted from Bloomberg, with a value of 1.91%.

By regressing³⁶ the excess returns of each one of the comparables (including the IHG) against the most appropriate market for each one (MSCI World index and STOXX Europe 600 Index), we could calculate the levered betas which were unlevered using the current debt-to-equity ratio of each company. All the IHG comparable³⁷ companies have a very close levered beta, being all of them bellow 1, with exception of Accor. This means that (with exception of Accor that is riskier than the market), IHG’s competitors are less risky than the market. However, looking into the 95% confidence interval, we cannot conclude that they have a beta bellow one – see exhibit 58.

Exhibit 58: Competitors’ Regression Outputs

	Upper Range	Levered Beta	Lower Range	R square
Accor	1.08	1.02	0.96	79%
Choice Hotels International	1.05	0.99	0.93	79%
Hilton WorldWide	1.04	0.98	0.92	77%
Hyatt Hotels Corporation	1.02	0.96	0.90	77%
Marriott internacional Inc.	1.04	0.98	0.92	78%
Wyndham Destinations	1.01	0.94	0.87	68%

Source: Analysts

³⁵ Equity Market Risk Premium – Research Summary

³⁶ For each regression we were using a sample of 311 observations, with a weekly frequency. IHG’s regression R Squared was 81%.

³⁷ The comparable are InterContinental Hotels Group, Accor, Choice Hotels international, Hilton Worldwide, Hyatt Hotels Corporation, Marriott International Inc., Wyndham Destinations.

Exhibit 59: IHG and its competitors' Net Debt to Equity ratio

	Net Debt/Equity
IHG	21.4%
Accor	11.2%
Choice Hotels International	18.3%
Hilton WorldWide	32.5%
Hyatt Hotels Corporation	13.2%
Marriott internacional Inc.	24.5%
Wyndham Destinations	78.2%

Source: Analysts

We believe that IHG's Net Debt to Equity ratio will converge to the median of industry³⁸– see exhibit 59. By using this input, we achieved a relevered beta of IHG of 0.95. Such beta means that the company's perceived systematic risk is below the market one, which is consistent with our analysis, since we were expecting the company to have less risk.

Subtracting the credit loss rate from the yield to maturity of the company's bonds outstanding, we were able to achieve the cost of debt. Since IHG is rated as BBB, and we expect the company to achieve its goal of keeping a target Net Debt to EBITDA around 2.75% in order to maintain a BBB credit rating, we applied a credit loss rate of 0.10%, assuming a 48.75% recovery rate and 0.20% probability of default.

With all the inputs we could estimate the most appropriate cost of capital, as well as an upper and lower bound – see exhibit 60.

Exhibit 60: WACC calculation

Levered Cost of Equity	7.40%
Expected Return on Cost of Debt	2.08%
Tax rate	19.00%
Target Net Debt/EV	17.63%
Target Equity/EV	82.37%
WACC (upper bound)	6.67%
WACC (lower bound)	6.12%
WACC	6.39%

Source: Analysts

Looking at the perpetual growth rate, in the last years of forecast, we can see that it starts to decrease and, in 2026 and 2027, it was almost constant. This evidence gave us enough security to consider that the 2028 FCF will be perpetual. Meaning that 1.71% will be the perpetual growth rate that we considered in order to calculate the terminal value, which is similar with the 2027F long-term real GDP growth of the regions where the Group has higher presence (North America has a forecasted long-term real GDP growth of 1.7% and Europe faces a forecast of 1.6% long-term real GDP growth).

Valuation Results

Our model outcome leads to a buy recommendation of IHG share, with a YE 2020 target share price of \$77.96 (meaning an increase of 14% comparing to its current share price of \$68.67).

We reached an enterprise value of 16,446 million \$. By subtracting Net Financial Debt and adding Non-Core fair value, we reached an equity value of 14,191 million \$. We also expect shareholders' gains in \$11.63 (return on shareholder' gains of 16.63%), which includes equity gains and total transactions with shareholders.

³⁸ Wyndham Destinations is the only one presenting a D/E ratio significantly different from the other competitors, being considered an outlier.

Multiples Valuation

Exhibit 61: Competitors' Financial Ratios

	Price/ Earnings	EV / Sales	EV/EBITDA
IHG	21.00	7.00	14.90
Accor	24.03	3.19	14.98
Hilton WorldWide	25.81	4.00	16.42
Hyatt Hotels	48.46	2.13	13.91

Source: Bloomberg

To obtain a more complete analysis, we decided to compute a multiples valuation so that we can understand the market perception on the major players of hotels' sector in comparison with IHG performance and value. We chose the direct competitors of IHG (not only in terms of revenues volume, but also because of having identical strategies and sources of revenues), listed in the previous "Valuation Assumptions" section. However, to do this multiple valuation we decided to exclude three³⁹ of them, due to being considered outliers, in order to have a more accurate valuation – see exhibit 61.

Exhibit 62: Multiples Valuation outcome

	Price/ Earnings	EV / Sales	EV/EBITDA
Average	29.83	4.08	15.05
Valuation	14,652.03	17,544.00	13,252.28
Price per share	80.491	96.378	72.801

Source: Analysts estimates

Using three different financial ratios⁴⁰, we estimated the market perceived IHG share price of \$83.22, by applying the average of the three prices reached by each ratio – see exhibit 62. In that way, we are able to conclude that market underestimate IHG share price, since the company's current traded price is \$68.67, which is in line with our valuation model outcome.

Scenario Analysis

Based on some of the most important IHG value drivers, and the risk the company and its sector face, we decided to elaborate on three different scenarios that may happen and bring deeper analysis to our valuation – see exhibit 63. In terms of probabilities, we decided to attribute the highest one to the base scenario (70%), since it is the one that we most believe will happen. For worst scenario, we believe it is the second with highest probability of occurrence (20%). So, in our opinion, the best scenario has only 10% probability of occurring.

Exhibit 63: Scenario Analysis

	Probability	New Hotels in Fee Business (variation from base scenario)	Royalty Rate (variation from base scenario)	Price \$	Total Shareholder Return	Recommendation
Base Scenario	70%	0%	0%	77.96	17%	BUY
Worst Scenario	20%	-10.0%	-0.5%	63.67	-4.8%	SELL
Best Scenario	10%	2.5%	0.10%	81.11	21.7%	BUY

Source: Analysts estimates

There is uncertainty and risks underlined company's pipeline, so our predictions for future number of IHG's hotels could not be accomplished, in a negative or even positive way. The other value driver we will be analysing here is the royalty

³⁹ Marriott, Wyndham and Choice Hotels

⁴⁰ Price/Earnings, Enterprise Value/Sales and Enterprise Value/EBITDA

rate. Due to its importance for our model and its associated risk, it becomes important to analyse and incorporate it in our scenarios.

Our model was built according to the base scenario, which includes forecasted royalty rate in all regions – see exhibit 64. In order to expand its fee business model, the Group will not be able to ask for higher royalty rate, so we believe they will achieve just 4%. Only in Greater China, due to the higher growth in this region, we are expecting to maintain a higher royalty rate (6%). Also, this scenario includes our forecasted number of new hotels – see exhibit 65 –

Exhibit 64: Forecasted Royalty Rate

	Royalty Rate								
	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
America	5.40%	5.00%	4.50%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
EMEA	4.25%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Greater China	6.05%	6.05%	6.05%	6.05%	6.05%	6.05%	6.05%	6.05%	6.05%

Source: Analysts estimates

Exhibit 65: Forecasted # of New Hotels in Fee Business

	# New Hotels Fee Business								
	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
America	117	139	143	148	141	145	125	128	131
EMEA	65	63	61	55	51	47	41	39	33
Greater China	69	48	48	48	48	48	48	48	48

Source: Analysts estimates

assuming the Group will be able to conclude all the expected hotels in time. With this scenario, we are predicting shareholders’ return of 17%⁴¹.

In the worst scenario, we decided to include our opinion about the worst case to the Group. All IHG’s industry is investing in fee business, which can lead to oversupply, meaning an excess of franchisors that will result in a decrease of IHG’s royalty rate, less 0.5% in relation to the base scenario. In this scenario, we are also including less 10% of new hotels, in order to incorporate the possibility of insolvency of some constructions, the end of some contracts and even the possibility that we could be a bit optimistic when forecasting it. The worst-case scenario will make us change our recommendation from “Buy” to “Sell”, since it gives a negative shareholder return, -4.8%, and a share price of \$63.67.

Exhibit 66: Scenario Analysis output

	Expected Share Price
Price \$	75.42
Total Shareholders Return	13%
Recommendation	BUY

Source: Analysts estimates

With just 10% of probability of occurrence, we decided to create the best-case scenario, incorporating the possibility of increase in royalty rate and 2.5% more new hotels comparing with the base scenario, in order to reflect the possibility of a higher increase in volume. The verification of this scenario would result in a share price of \$81.11 and 21.7% of shareholder return.

Weighting the probabilities of occurrence of the three scenarios, we achieve an expected share price of \$75.42, with a total shareholder return of 13% – see exhibit 66 –, ending up with the same recommendation as the initial base scenario – “Buy”.

⁴¹ Including all shareholders gains, and a share price of \$77.96.

Sensitivity Analysis

Since WACC and perpetual growth rate are considered one of the most important variables to model share prices, we decided to conduct a sensitivity analysis on which it is possible to assess the impact on the IHG FY20 share price – see exhibit 67.

Exhibit 67: Sensitivity Analysis outcome – WACC vs Perpetual Growth

		Share Price, \$	WACC				
		77.96	6.0%	6.2%	6.4%	6.6%	6.8%
Perpetual Growth	1.3%	79.87	75.88	72.20	68.80	65.66	
	1.5%	83.21	78.91	74.96	71.33	67.97	
	1.7%	86.86	82.21	77.96	74.06	70.47	
	1.9%	90.87	85.82	81.23	77.02	73.17	
	2.1%	95.29	89.78	84.79	80.25	76.10	

Source: Analysts estimates

An increase in WACC in 0.2 basis points will lead to a decrease of 5.0% in the share price (now: \$74.06), *ceteris paribus*. In the opposite, a decrease in WACC in 0.2 basis points will have an impact of 5.5% in the price (now: \$82.21) maintaining the current perpetual growth rate. We can conclude that share price is more sensible to decreases in WACC rather than increases.

The same analysis can be applicable to variations in perpetual growth rate. An increase of 0.2 basis point in the current rate of 1.7% will lead to a higher share price (+4.2%), *ceteris paribus*. In the opposite, if it is verified a perpetual growth of 1.5%, the IHG share price will decrease to \$74.96 (-3.8%). We are able to conclude that share price is more sensible to increases of perpetual growth rate rather than decreases.

By analysing such impacts, we can ultimately conclude that both model inputs need to be well estimated in order to achieve accurate results so that investors may trust in our previsions for the FY20 IHG share price. In fact, these two metrics can have a giant impact in our valuation, as we could understand from this sensitivity analysis.

Exhibit 68: Sensitivity Analysis outcome – Occupation Rate vs % Ownership Assets

		Share Price, \$	Occupation Rate (variation from base)				
		77.96	-2.5 bp	-1.5 bp	0 bp	1.5 bp	2.5 bp
% Ownership Assets (variation from base)	-0.1 bp	64.54	67.49	72.65	78.88	83.77	
	-0.05 bp	66.35	69.60	75.30	82.21	87.65	
	0 bp	68.17	71.72	77.96	85.55	91.56	
	0.05 bp	69.99	73.85	80.63	88.91	95.49	
	0.1 bp	71.83	75.98	83.31	92.29	99.45	

Source: Analysts estimates

A sensitivity analysis on Occupancy Rate and % of ownership assets was also conducted, trying to understand how sensible the share price is to them, since they are two important value drivers – see exhibit 68.

A variation of 1.5 basis points in occupation rate (in all applicable regions) will lead to an increase of 9.7% in share price while a decrease in occupation rate in the same proportion will lead to a decrease in share price of 8.0%. Looking to the % of ownership assets, a variation of 0.05 or -0.05 basis points will lead to an increase or decrease of 3.4%, respectively. In both cases, we can conclude that a reduction from the initial forecasted point will lead to a lower share price, meaning that if the company reduce more the percentage of ownership assets than what we are expecting the share price will be lower.

Appendix

Financial Statements – Balance Sheet

\$ in millions

Operational	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Operating Cash	\$ 131	\$ 164	\$ 202	\$ 221	\$ 228	\$ 236	\$ 238	\$ 251	\$ 264	\$ 277	\$ 290	\$ 304
Trade and other receivables	\$ 477	\$ 551	\$ 613	\$ 637	\$ 646	\$ 655	\$ 661	\$ 696	\$ 731	\$ 768	\$ 805	\$ 844
Contract assets	\$ 198	\$ 258	\$ 290	\$ 326	\$ 365	\$ 399	\$ 434	\$ 464	\$ 480	\$ 495	\$ 509	\$ 524
Property, plant and equipment	\$ 419	\$ 425	\$ 447	\$ 486	\$ 503	\$ 511	\$ 517	\$ 531	\$ 531	\$ 531	\$ 531	\$ 531
Tax receivable	\$ 100	\$ 117	\$ 58	\$ 60	\$ 61	\$ 62	\$ 62	\$ 65	\$ 69	\$ 72	\$ 76	\$ 79
Goodwill	\$ 232	\$ 237	\$ 313	\$ 313	\$ 313	\$ 313	\$ 313	\$ 313	\$ 313	\$ 313	\$ 313	\$ 313
Other intangible assets	\$ 626	\$ 730	\$ 830	\$ 867	\$ 884	\$ 900	\$ 915	\$ 963	\$ 1,012	\$ 1,063	\$ 1,115	\$ 1,168
Others	\$ 56	\$ 61	\$ 65	\$ 67	\$ 68	\$ 69	\$ 70	\$ 73	\$ 77	\$ 81	\$ 85	\$ 89
Total Operating Assets	\$ 2,239	\$ 2,543	\$ 2,818	\$ 2,979	\$ 3,068	\$ 3,145	\$ 3,210	\$ 3,356	\$ 3,477	\$ 3,599	\$ 3,724	\$ 3,852
Trade and other payables	\$ (555)	\$ (633)	\$ (776)	\$ (861)	\$ (881)	\$ (875)	\$ (871)	\$ (875)	\$ (879)	\$ (885)	\$ (892)	\$ (899)
Deferred revenue	\$ (1,314)	\$ (1,357)	\$ (1,506)	\$ (1,549)	\$ (1,553)	\$ (1,557)	\$ (1,571)	\$ (1,654)	\$ (1,739)	\$ (1,825)	\$ (1,915)	\$ (2,007)
Tax payable	\$ (50)	\$ (89)	\$ (50)	\$ (60)	\$ (61)	\$ (62)	\$ (62)	\$ (65)	\$ (69)	\$ (72)	\$ (76)	\$ (79)
Provisions	\$ (8)	\$ (8)	\$ (27)	\$ (28)	\$ (28)	\$ (29)	\$ (29)	\$ (30)	\$ (32)	\$ (34)	\$ (35)	\$ (37)
Total Operating Liabilities	\$ (1,927)	\$ (2,087)	\$ (2,359)	\$ (2,498)	\$ (2,523)	\$ (2,522)	\$ (2,534)	\$ (2,625)	\$ (2,718)	\$ (2,816)	\$ (2,918)	\$ (3,022)
Net Operational Result	\$ 312	\$ 456	\$ 459	\$ 481	\$ 544	\$ 622	\$ 676	\$ 731	\$ 759	\$ 782	\$ 806	\$ 830
Non-Operational	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Other financial assets	\$ 268	\$ 244	\$ 261	\$ 258	\$ 258	\$ 258	\$ 258	\$ 258	\$ 258	\$ 258	\$ 258	\$ 258
Deferred tax assets	\$ 69	\$ 75	\$ 60	\$ 98	\$ 98	\$ 100	\$ 101	\$ 113	\$ 126	\$ 138	\$ 150	\$ 164
Investment in associates and joint ventures	\$ 111	\$ 141	\$ 104	\$ 104	\$ 104	\$ 104	\$ 104	\$ 104	\$ 104	\$ 104	\$ 104	\$ 104
Others	\$ -	\$ 3	\$ 8	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Non-Operational Assets	\$ 448	\$ 463	\$ 433	\$ 460	\$ 459	\$ 462	\$ 463	\$ 475	\$ 487	\$ 499	\$ 512	\$ 525
Derivative financial instruments	\$ (3)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Retirement benefit obligations	\$ (96)	\$ (104)	\$ (91)	\$ (96)	\$ (100)	\$ (104)	\$ (107)	\$ (111)	\$ (115)	\$ (119)	\$ (123)	\$ (128)
Deferred tax liabilities	\$ (170)	\$ (101)	\$ (131)	\$ (186)	\$ (185)	\$ (190)	\$ (192)	\$ (214)	\$ (238)	\$ (261)	\$ (284)	\$ (310)
Total Non-Operational Liabilities	\$ (269)	\$ (205)	\$ (222)	\$ (282)	\$ (285)	\$ (293)	\$ (300)	\$ (326)	\$ (353)	\$ (380)	\$ (408)	\$ (437)
Net Non Operational	\$ 179	\$ 258	\$ 211	\$ 178	\$ 174	\$ 168	\$ 164	\$ 149	\$ 134	\$ 119	\$ 104	\$ 88
Financing	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Excess cash	\$ 75	\$ 4	\$ 502									
Loans and other borrowings	\$ (1,712)	\$ (2,019)	\$ (2,249)									
Net debt	\$ (1,637)	\$ (2,015)	\$ (1,747)	\$ (2,427)	\$ (2,421)	\$ (2,475)	\$ (2,505)	\$ (2,757)	\$ (3,017)	\$ (3,270)	\$ (3,532)	\$ (3,814)
Non-Controlling Interest	\$ (8)	\$ (7)	\$ (8)	\$ (8)	\$ (8)	\$ (8)	\$ (8)	\$ (8)	\$ (8)	\$ (8)	\$ (8)	\$ (8)
Net Financial	\$ (1,645)	\$ (2,022)	\$ (1,755)	\$ (2,435)	\$ (2,429)	\$ (2,482)	\$ (2,512)	\$ (2,765)	\$ (3,025)	\$ (3,278)	\$ (3,539)	\$ (3,821)
TOTAL IHG SHAREHOLDERS' EQUITY	\$ (1,154)	\$ (1,308)	\$ (1,085)	\$ (1,775)	\$ (1,710)	\$ (1,692)	\$ (1,672)	\$ (1,884)	\$ (2,131)	\$ (2,376)	\$ (2,629)	\$ (2,903)

Financial Statements – Income Statement

<i>\$ in millions</i>	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Net Revenues												
Americas	\$ 969	\$ 999	\$ 1,051	\$ 1,075	\$ 1,049	\$ 1,004	\$ 952	\$ 989	\$ 1,026	\$ 1,064	\$ 1,103	\$ 1,142
EMEA	\$ 439	\$ 457	\$ 569	\$ 585	\$ 602	\$ 637	\$ 673	\$ 710	\$ 748	\$ 789	\$ 830	\$ 874
Greater China	\$ 112	\$ 117	\$ 143	\$ 163	\$ 183	\$ 204	\$ 227	\$ 251	\$ 278	\$ 305	\$ 335	\$ 366
Central	\$ 147	\$ 157	\$ 170	\$ 183	\$ 196	\$ 209	\$ 221	\$ 232	\$ 242	\$ 250	\$ 258	\$ 264
Revenue from reportable segments	\$ 1,667	\$ 1,730	\$ 1,933	\$ 2,006	\$ 2,030	\$ 2,054	\$ 2,073	\$ 2,182	\$ 2,294	\$ 2,408	\$ 2,526	\$ 2,647
Cost of sales	\$ (548)	\$ (571)	\$ (706)	\$ (782)	\$ (800)	\$ (793)	\$ (790)	\$ (793)	\$ (796)	\$ (802)	\$ (809)	\$ (815)
Staff Costs	\$ (536)	\$ (570)	\$ (604)	\$ (676)	\$ (692)	\$ (685)	\$ (680)	\$ (678)	\$ (675)	\$ (675)	\$ (675)	\$ (675)
Other cost of sales	\$ (12)	\$ (1)	\$ (102)	\$ (106)	\$ (107)	\$ (108)	\$ (109)	\$ (115)	\$ (121)	\$ (127)	\$ (133)	\$ (140)
GROSS PROFIT	\$ 1,119	\$ 1,159	\$ 1,227	\$ 1,224	\$ 1,230	\$ 1,261	\$ 1,283	\$ 1,389	\$ 1,497	\$ 1,605	\$ 1,717	\$ 1,832
Net System Fund Revenues	\$ 35	\$ (34)	\$ (146)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Depreciation and amortisation	\$ (75)	\$ (78)	\$ (80)	\$ (88)	\$ (91)	\$ (93)	\$ (94)	\$ (96)	\$ (96)	\$ (96)	\$ (96)	\$ (96)
Other operating income	\$ 9	\$ 11	\$ 14	\$ 15	\$ 15	\$ 16	\$ 16	\$ 16	\$ 16	\$ 16	\$ 16	\$ 16
Administrative expenses before exceptional items	\$ (345)	\$ (337)	\$ (344)	\$ (354)	\$ (363)	\$ (375)	\$ (386)	\$ (400)	\$ (414)	\$ (430)	\$ (447)	\$ (459)
Income from operations	\$ 743	\$ 721	\$ 671	\$ 797	\$ 792	\$ 810	\$ 819	\$ 909	\$ 1,003	\$ 1,095	\$ 1,190	\$ 1,293
Tax	\$ 219	\$ 147	\$ 169	\$ 224	\$ 223	\$ 228	\$ 230	\$ 255	\$ 282	\$ 308	\$ 335	\$ 363
NOPLAT	\$ 524	\$ 574	\$ 502	\$ 573	\$ 569	\$ 582	\$ 589	\$ 653	\$ 721	\$ 787	\$ 856	\$ 929
Non-Operational												
Impairment charges	\$ (16)	\$ (18)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Share of (losses)/gains of associates and joint ventures	\$ (2)	\$ 3	\$ (1)	\$ (2)	\$ (2)	\$ (2)	\$ (2)	\$ (2)	\$ (2)	\$ (2)	\$ (2)	\$ (2)
Other exceptional items	\$ (13)	\$ 22	\$ (104)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Financial income	\$ 6	\$ 4	\$ 5	\$ 5	\$ 5	\$ 5	\$ 5	\$ 5	\$ 5	\$ 5	\$ 5	\$ 5
Tax	\$ (29)	\$ (18)	\$ (20)	\$ (7)	\$ (7)	\$ (7)	\$ (7)	\$ (7)	\$ (7)	\$ (7)	\$ (7)	\$ (7)
Total OCI Non-operational	\$ 190	\$ (103)	\$ 37	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Non-Operational Result	\$ 194	\$ (74)	\$ (43)	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10
Financial												
Financial expenses	\$ (86)	\$ (76)	\$ (86)	\$ (109)	\$ (108)	\$ (110)	\$ (111)	\$ (120)	\$ (129)	\$ (139)	\$ (148)	\$ (158)
Interest expense on borrowings	\$ 71	\$ 62	\$ 66	\$ 89	\$ 88	\$ 90	\$ 91	\$ 100	\$ 109	\$ 119	\$ 128	\$ 138
Finance charge payable under finance leases	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20	\$ 20
Capitalised interest	\$ (5)	\$ (6)	\$ (5)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Change in fair value of deferred and contingent purchases	\$ -	\$ -	\$ 5	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Tax Shield	\$ (17)	\$ (15)	\$ (16)	\$ (21)	\$ (20)	\$ (21)	\$ (21)	\$ (23)	\$ (25)	\$ (26)	\$ (28)	\$ (30)
Total OCI Financial	\$ (2)	\$ (32)	\$ (4)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Financial Result	\$ (71)	\$ (93)	\$ (74)	\$ (89)	\$ (87)	\$ (89)	\$ (90)	\$ (97)	\$ (105)	\$ (112)	\$ (120)	\$ (128)
COMPREHENSIVE INCOME	\$ 647	\$ 406	\$ 385	\$ 494	\$ 491	\$ 503	\$ 509	\$ 566	\$ 626	\$ 685	\$ 745	\$ 811

Financial Statements – Cash Flow Statement

\$ in millions

Operational	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
NOPLAT	\$ 524	\$ 574	\$ 502	\$ 573	\$ 569	\$ 582	\$ 589	\$ 653	\$ 721	\$ 787	\$ 856	\$ 929
Depreciation	\$ 75	\$ 78	\$ 80	\$ 88	\$ 91	\$ 93	\$ 94	\$ 96	\$ 96	\$ 96	\$ 96	\$ 96
Operational Cash Flow	\$ 599	\$ 652	\$ 582	\$ 661	\$ 660	\$ 675	\$ 683	\$ 750	\$ 817	\$ 884	\$ 952	\$ 1,026
Invested Capital - Fixed Assets	\$ 419	\$ 425	\$ 447	\$ 486	\$ 503	\$ 511	\$ 517	\$ 531	\$ 531	\$ 531	\$ 531	\$ 531
Gross CAPEX investment		\$ 6	\$ 22	\$ 39	\$ 17	\$ 8	\$ 6	\$ 14	\$ (0)	\$ -	\$ -	\$ -
Net CAPEX		\$ 84	\$ 102	\$ 127	\$ 108	\$ 101	\$ 100	\$ 110	\$ 96	\$ 96	\$ 96	\$ 96
Invested Capital - NWC	\$ 53	\$ 82	\$ 39	\$ (3)	\$ (7)	\$ 16	\$ 28	\$ 72	\$ 116	\$ 159	\$ 203	\$ 249
Δ NWC		\$ 29	\$ (43)	\$ (42)	\$ (4)	\$ 23	\$ 12	\$ 44	\$ 45	\$ 43	\$ 44	\$ 46
Δ Other Assets		\$ 191	\$ 153	\$ 78	\$ 56	\$ 52	\$ 51	\$ 85	\$ 73	\$ 72	\$ 74	\$ 76
Δ Other Liabilities		\$ (82)	\$ (129)	\$ (54)	\$ (5)	\$ (5)	\$ (15)	\$ (88)	\$ (90)	\$ (92)	\$ (94)	\$ (97)
Investment Cash Flow		\$ 222	\$ 83	\$ 110	\$ 155	\$ 170	\$ 148	\$ 151	\$ 124	\$ 120	\$ 120	\$ 120
Free Cash Flow Operations		\$ 430	\$ 499	\$ 551	\$ 506	\$ 504	\$ 535	\$ 598	\$ 694	\$ 764	\$ 832	\$ 906
Non-Operating	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Non-Core Result	\$ 194	\$ (74)	\$ (43)	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10	\$ 10
Invested Capital	\$ 179	\$ 258	\$ 211	\$ 178	\$ 174	\$ 168	\$ 164	\$ 149	\$ 134	\$ 119	\$ 104	\$ 88
Investment Cash Flow		\$ (79)	\$ 47	\$ 33	\$ 4	\$ 6	\$ 5	\$ 14	\$ 15	\$ 15	\$ 15	\$ 16
Free Cash Flow Non Core Business		\$ (153)	\$ 4	\$ 42	\$ 13	\$ 16	\$ 14	\$ 24	\$ 25	\$ 24	\$ 25	\$ 26
FREE CASH FLOW	\$ 277	\$ 503	\$ 593	\$ 519	\$ 520	\$ 549	\$ 622	\$ 718	\$ 788	\$ 857	\$ 931	
Financing	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Financial result	\$ (71)	\$ (93)	\$ (74)	\$ (89)	\$ (87)	\$ (89)	\$ (90)	\$ (97)	\$ (105)	\$ (112)	\$ (120)	\$ (128)
Net Financial Assets	\$ (1,645)	\$ (2,022)	\$ (1,755)	\$ (2,435)	\$ (2,429)	\$ (2,482)	\$ (2,512)	\$ (2,765)	\$ (3,025)	\$ (3,278)	\$ (3,539)	\$ (3,821)
Investment in net Financial Assets		\$ 377	\$ (267)	\$ 680	\$ (6)	\$ 54	\$ 30	\$ 253	\$ 260	\$ 253	\$ 262	\$ 282
Net Cash Transactions with Shareholders		\$ (560)	\$ (162)	\$ (1,184)	\$ (426)	\$ (484)	\$ (489)	\$ (778)	\$ (873)	\$ (929)	\$ (999)	\$ (1,085)
Financing Cash Flow	\$ (277)	\$ (503)	\$ (593)	\$ (519)	\$ (520)	\$ (549)	\$ (622)	\$ (718)	\$ (788)	\$ (857)	\$ (931)	

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Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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A Work Project, presented as part of the requirements for the Award of a Master Degree in Economics / Finance / Management from the NOVA – School of Business and Economics.

ANALYSIS OF THE BUSINESS MODELS' IMPACT
IN THE COMPANY VALUE – THE CASE OF
INTERCONTINENTAL HOTELS GROUP

PEDRO ALEXANDRE SANTOS AVELAR – 33955

A Project carried out on the Master in Finance Program, under the supervision of:

(Francisco Martins)

3 JANUARY 2020

Abstract

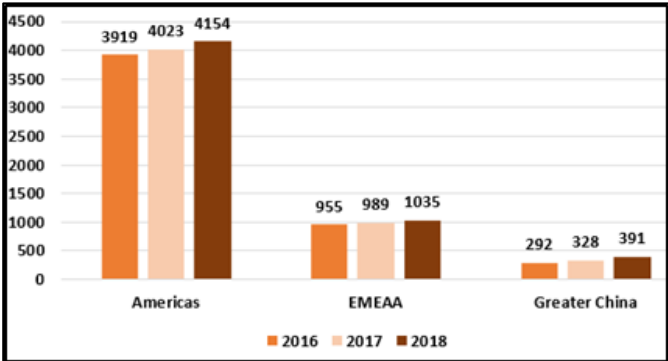
IHG is characterized by having three different business models, consolidated in two categories – (i) Fee Business and (ii) Owned, Leased and Managed Lease. The current trend faced by hotel industry is to increase the number of hotels in (i), rather than in (ii). With seven scenarios, this study analyses the impact of such strategy in the company's FY20 share price, as well as the forecasted shareholders' return. The main purpose is to understand why this trend is being adopted by IHG and figure out what will be the future strategic path.

Keywords:

- Strategy
- Impact
- Scenarios
- Value

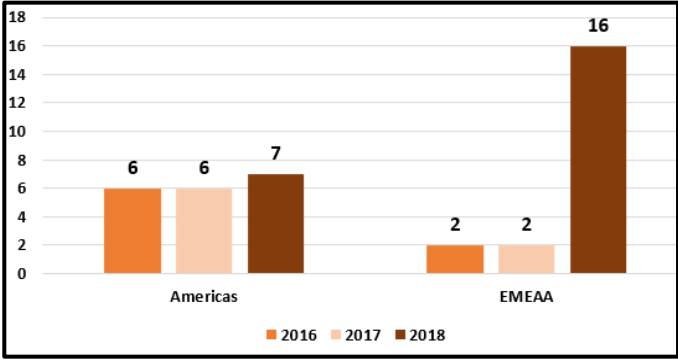
The current IHG operations comprise three business models: (i) franchised, (ii) managed and (iii) owned, leased and managed lease (OLML). Franchised hotels’ ownership and operations are assumed by parties distinct from the hotel brand, paying fees to the company for the use of the brand and managed hotels’ operations are assumed by a party distinct from the hotel owner, paying management fees and, if that hotel uses a third-party brand name, also needs to pay fees to that third-party. These two types of hotels are characterized by an asset-light strategy and represent the “Fee-Business” category, which represent more than 99% of the total IHG hotels. Owned, leased and managed lease hotels’ management and operations are insured by IHG. By analyzing exhibits 1 and 2, we can conclude that IHG is developing its asset-light strategy, increasing the hotels number in fee-business in all geographical regions (Americas, EMEAA and Greater China). In 2018, it was verified an increase of 6.00% (Americas), 8.38% (EMEAA) and 33.90% (Greater China) in this hotels’ type compared to 2016. Regarding OLML hotels, Greater China have no hotels from this category. Between 2016 and 2017 the number of OLML hotels did not increase in the remaining two regions, however it registered and increase in 2018 (+1 in Americas and +14 in EMEAA).

Exhibit 1: Evolution of IHG Fee Business Hotels in all geographical regions (2016 – 2018)



Source: Company Data

Exhibit 2: Evolution of IHG OLML Hotels in all geographical regions (2016 – 2018)



Source: Company Data

It is important to analyse the impact of both strategies in IHG FY20 share price and how the company will be able to maximize its value and shareholders’ return. In that way, and having as base scenario the main report forecasted results, I decided to perform five different scenarios in order to assess if the current company strategy is the one that allow better results (such as revenues, EBITDA and costs) and higher forecasted share price. The five scenarios are the following: (1) Ten more hotels in Americas, in fee-business; (2) Ten more hotels in EMEAA, in fee-business; (3) Ten more hotels in Greater China, in fee-business; (4) Ten more hotels in Americas, in OLML; (5) Ten more hotels in EMEAA, in OLML; (6) Only fee-business hotels, in Americas; (7) Only fee-business hotels, in EMEAA.

The forecasted (2020F – 2027F) number of hotels in fee business and OLML are illustrated in exhibit 3. It is expected that OLML hotels will maintain in number since 2020 (increase of 1 and 4 in Americas and EMEAA, in 2019, due to IHG’s pipeline). It was assumed that fee business hotels will keep the growth trend in all geographies.

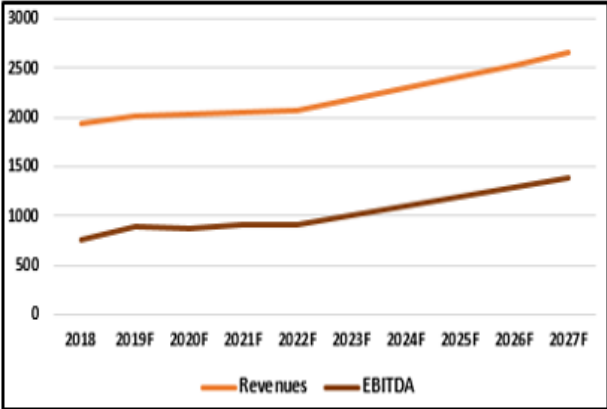
Based on this forecast, it is predicted a progressive increase in revenues and EBITDA, as shown in exhibit 4. The valuation outputs were a FY20 IHG share price of \$77.96 and 16.93% of shareholders’ gains.

Exhibit 3: Forecasted number of hotels and rooms in all geographical regions- Base Scenario (2020F – 2027F)

Americas	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Owned, leased and managed lease hotels								
# Hotels	7	7	7	7	7	7	7	7
# Rooms	2,223	2,223	2,223	2,223	2,223	2,223	2,223	2,223
Fee business								
# Hotels	4,410	4,553	4,701	4,843	4,988	5,112	5,240	5,371
# Rooms	532,740	547,201	561,662	576,123	590,584	605,044	619,505	633,966
EMEAA	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Owned, leased and managed lease hotels								
# Hotels	20	20	20	20	20	20	20	20
# Rooms	4,269	4,269	4,269	4,269	4,269	4,269	4,269	4,269
Fee business								
# Hotels	1,164	1,225	1,280	1,331	1,378	1,419	1,458	1,491
# Rooms	224,817	235,098	245,380	255,661	265,943	276,224	286,506	296,787
Greater China	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Owned, leased and managed lease hotels								
# Hotels	0	0	0	0	0	0	0	0
# Rooms	0	0	0	0	0	0	0	0
Fee business								
# Hotels	508	555	603	650	698	746	793	841
# Rooms	146,057	157,294	168,531	179,769	191,006	202,243	213,480	224,717

Source: Analysts

Exhibit 4: Forecasted Revenues and EBITDA – Base Scenario (in million \$)



Source: Analysts

For scenarios 1, 2 and 3 I added ten hotels in the base scenario's fee business forecasted numbers (for each year from 2020 onwards), for each one of the regions (and also adjusted number of rooms), maintaining the number of forecasted OLML hotels and rooms – see exhibit 5. The achieved results are presented in exhibit 6: as expected, the increase in the number of fee business hotels will affect positively revenues and EBITDA. The highest impact was verified in Greater China, where the increase in ten fee business hotels is expected to increase revenues and EBITDA in 4 million \$ (in 2020).

Exhibit 5: Forecasted number of Fee Business hotels and rooms in all geographical regions – Scenarios 1, 2 & 3 (2020F – 2027F)

	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Scenario 1								
#Hotels	4,420	4,563	4,711	4,853	4,998	5,122	5,250	5,381
#Rooms	533,950	548,411	562,872	577,333	591,794	606,254	620,715	635,176
Scenario 2								
#Hotels	1,174	1,235	1,290	1,341	1,388	1,429	1,468	1,501
#Rooms	226,747	237,028	247,310	257,591	267,873	278,154	288,436	298,717
Scenario 3								
#Hotels	460	518	565	613	660	708	756	803
#Rooms	134,820	148,937	160,174	171,411	182,649	193,886	205,123	216,360

Source: Analyst

Exhibit 6: Forecasted Revenues and EBITDA – Scenarios 1, 2 & 3 (in million \$) (2020F – 2027F)

	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Base Scenario								
Revenues	2,030	2,054	2,073	2,182	2,294	2,408	2,526	2,647
EBITDA	880	900	911	1,003	1,097	1,189	1,284	1,387
Scenario 1								
Revenues	2,032	2,056	2,075	2,184	2,296	2,410	2,528	2,649
EBITDA	882	901	912	1,004	1,099	1,191	1,286	1,388
Scenario 2								
Revenues	2,033	2,057	2,076	2,185	2,297	2,411	2,529	2,651
EBITDA	883	902	913	1,005	1,100	1,192	1,287	1,390
Scenario 3								
Revenues	2,034	2,058	2,077	2,187	2,298	2,413	2,531	2,652
EBITDA	884	903	914	1,006	1,101	1,193	1,289	1,391

Source: Analyst

For Scenario 1, the FY20 IHG share price is \$78.03, an increase of 0.09% comparing with base scenario forecasted share price (with 17.08% of shareholders' gains). In case of Scenario 2, it was reached a share price of \$78.11 (an increase of 0.20% comparing to base scenario FY20 share price), corresponding to a shareholders' gains of 17.22%. In case of Scenario 3, the FY20 share price was \$78.20 (an increase of 0.30% comparing to base scenario FY20 IHG's share price), corresponding to a shareholders' gains of 20.69%. From these three scenarios, we can conclude that IHG will maximize the most its forecasted FY20 share price, value and shareholders' gains by increasing the number of fee business hotels in Greater China.

For scenarios 4 and 5 I added ten hotels in the base scenario's OLML forecasted numbers (for each year from 2020 onwards), in Americas and EMEAA regions (and also adjusted number of

rooms), maintaining the number of forecasted fee business hotels and rooms (I did not perform such analysis for Greater China since there are not any hotels from this type and it is not expected to have) – see exhibit 7. The achieved results are presented in exhibit 8: as expected, the increase in the number of hotels will affect negatively IHG’s costs and positively revenues. The overall result will be a decrease in EBITDA. The highest revenues and costs impact was verified in Americas, where the increase in ten OLML hotels is expected to increase revenues in 301 million \$ and increase costs in 354 million \$ (in 2020). In terms of EBITDA impact, an increase in ten OLML hotels in EMEAA will decrease IHG’s in 84 million \$.

Exhibit 7: Forecasted number of OLML hotels and rooms in all geographical regions – Scenarios 4 & 5 (2020F – 2027F)

	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Scenario 4								
#Hotels	17	17	17	17	17	17	17	17
#Rooms	5,393	5,393	5,393	5,393	5,393	5,393	5,393	5,393
Scenario 5								
#Hotels	30	30	30	30	30	30	30	30
#Rooms	6,399	6,399	6,399	6,399	6,399	6,399	6,399	6,399

Source: Analyst

Exhibit 8: Forecasted Revenues and EBITDA – Scenarios 4 & 5 (in million \$) (2020F – 2027F)

	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
Base Scenario								
Revenues	2,030	2,054	2,073	2,182	2,294	2,408	2,526	2,647
Costs	800	793	790	793	796	802	809	815
EBITDA	880	900	911	1,003	1,097	1,189	1,284	1,387
Scenario 4								
Revenues	2,331	2,362	2,388	2,505	2,624	2,746	2,871	3,001
Costs	1,154	1,144	1,139	1,141	1,143	1,150	1,157	1,163
EBITDA	827	857	877	977	1,080	1,179	1,282	1,392
Scenario 5								
Revenues	2,171	2,200	2,225	2,340	2,457	2,577	2,702	2,830
Costs	1,034	1,026	1,021	1,024	1,026	1,033	1,039	1,046
EBITDA	786	813	831	929	1,030	1,128	1,229	1,338

Source: Analyst

For Scenario 4, the FY20 IHG share price is \$62.61 (sell recommendation), a decrease of 19.70% comparing with base scenario forecasted share price (with 9.18% of shareholders’ losses). In case of Scenario 5, it was reached a share price of \$75.40 (a decrease of 3.28% comparing to base scenario FY20 share price), corresponding to a shareholders’ gains of 11.95%. From these two scenarios, we can conclude that IHG will not maximize its forecasted FY20 share price, value and shareholders’ gains by increasing the number OLML hotels. Based on these five scenarios, we can also conclude that, in order to increase its share price, IHG should grow its asset-light strategy, more specifically in Greater China. By doing that, the company will achieve better results in a faster way.

Based on all of the five scenarios that I set, we can conclude that:

- ✓ IHG would increase its value and forecasted share price by increasing the number of fee business hotels in any of the geographical region: Americas, EMEAA and Greater China [Scenarios 1, 2 & 3];
- ✓ IHG would not increase its value and forecasted share price in case of increasing the number of OLML hotels in Americas and EMEAA [Scenarios 4 & 5];
- ✓ IHG would maximize the most its value and forecasted share price by increasing the number of fee business hotels in Greater China [all scenarios conclusion].